The New York Fiduciary Concept in Incorporated Partnerships and Joint Ventures

Francis X. Conway
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FRANCIS X. CONWAY*

THE basic problem considered in this article is fairly limited in scope. It concerns the almost total failure of the New York courts to enforce fiduciary obligations, or agreements giving rise to such, between the co-owners of a business venture where they have seen fit to carry it on as partners or joint adventurers under the corporate form.

The prevalent view of the New York courts regarding this problem was epitomized four years ago in a pithy statement by the then Chief Judge of the New York Court of Appeals, in Weisman v. Awnair Corp. of America. Refusing to recognize the creation of a “joint venture corporation” by the co-owners of a business, Judge Conway stated: [T]he rule is well settled that a joint venture may not be carried on by individuals through a corporate form.

The present Chief Judge, Desmond, in a lone dissent, expressed what this writer and, it would appear, the majority of jurisdictions, consider to be the more logical, and certainly the more realistic approach:

* Associate Professor of Law, Fordham University, School of Law.
2. Id. at 449, 144 N.E.2d at 418, 165 N.Y.S.2d at 749. Judge Conway emphasized the word “through” apparently to make it clear, as he stated later in the majority opinion, that corporations may be parties to a joint venture. The general rule at common law denied corporations the power to be partners, since this would involve an abdication by the board of directors of their exclusive right to manage corporate affairs, partners being mutual general agents for each other while acting in the general business of the partnership. No such broad agency exists in the case of the joint venture, which, for our purposes, may be defined as an arrangement between or among individuals, firms or corporations to carry on for profit a single business enterprise, be it great or small. Being thus limited in scope, the extent of the legal incidents are similarly limited, such as the fiduciary duty and the power of representation of the adventurers. Compared to the partnership, the joint venture is a relatively modern concept. Generally speaking, the principles of the law of partnership apply, at least by analogy, Mechem, The Law of Joint Adventure, 15 Minn. L. Rev. 644 (1931); Comment, The Joint Venture: Problem Child of Partnership, 33 Calif. L. Rev. 860, 870-74 (1950). For purposes of this paper any distinction between the partnership and joint venture may be ignored. In fact the distinction mentioned above is today somewhat academic and in 1963 will be obsolete in New York. See Comment, Joint Venture or Partnership, 13 Fordham L. Rev. 114, 127-28 n.75 (1949) where it is said: “However, since the distinction between the power of representation in the two relations is principally a matter of degree, it would seem that the joint venture concept has merely furnished the courts with a means of holding intra vires a transaction which by precedent would be considered as ultra vires.” There is no practical business reason why a corporation should not be permitted to be a partner. Note, The Corporate Partner: An Exercise In Semantics, 35 N.Y.U.L. Rev. 543 (1960). The recently enacted N.Y. Bus. Corp. Law § 202(15) provides that a corporation shall have power to be a partner.
We are asked to hold here that individuals agreeing to go into business together and to carry out that business through a corporation cannot enforce such an agreement. Not only is there nothing illegal about such a plan but I venture to say it is one of the commonest of modern day business arrangements.  

A reconsideration of the problem is now in order for a number of reasons. First, although statements by most of the New York courts clearly represent the minority view, there are some in the New York judiciary who do not appear to concur, and the court of appeals may not have had its final say in the matter. The recent prevalence of the majority view, the lack of support in basic law behind the minority view, and the inequities which result from it, do not appear to have been thoroughly presented to the court of appeals or to the lower New York courts. Secondly, the recently enacted New York Business Corporation Law, which becomes effective on April 1, 1963, and which is subject to possible amendment during the 1962 and 1963 sessions of the legislature, does not specifically deal with the basic problem.

While the solution to the question now to be considered should not necessarily be based upon the traditional legal differences between the corporation and various forms of unincorporated business enterprises, an analysis of the New York position does require some reference to those differences and to certain old and modern thinking concerning the corporate device, the latter pertaining particularly to the so-called "close corporation."

DISTINCTIONS BETWEEN THE CORPORATION AND THE UNINCORPORATED VENTURE

The most familiar and important practical and economic incident of incorporation is the limitation of personal liability of the members. This may be contrasted with the absence of such immunity in the case of the partnership and joint venture. This differentiating feature is not so evident when the corporation is compared with other unincorporated business groups, viz, joint stock associations and business trusts. Theoretically the law does not accord limited liability to the members of such

4. 3 N.Y.2d 444, 452, 144 N.E.2d 415, 419, 165 N.Y.S.2d 745, 752 (1957) (dissenting opinion). It should be noted that Judge Fuld concurred in the majority opinion on a separate ground not involved in the above quotations.

5. The briefs in the New York cases for the most part simply cite New York decisions and generally fail to analyze the fundamental problem. The appellants' brief in the Weisman case barely touches on the basic issue and makes no attempt to persuade the court of appeals to adopt the more modern view of the majority of jurisdictions and of legal scholars. It must be remembered that it is the principal function of the court of appeals not so much to decide individual controversies as to establish the law for the guidance of the lower courts and the legal profession. Cohen & Karger, The Powers of the New York Court of Appeals § 3, at 16 (1952).

groups, although for most practical purposes such immunity exists.\(^7\) In any event, although freedom from personal liability does seem to fit exactly into the entity theory, which we shall discuss, this incident, albeit of great practical importance, is not really intrinsic to the corporate concept.\(^8\) The non-essentiality of limited liability to the idea of incorporation must be borne in mind, when we analyze the views expressed by the court of appeals.

The traditional and really essential distinction between the corporation and unincorporated groups stems from the common law's theoretical approach to the nature of the corporation, an approach having a two-fold foundation—the fiction or entity theory and the concession theory.

The orthodox common-law concept of a corporation is that it is an entity, separate and distinct from the members who compose it, and endowed by law with a separate legal personality. This legal person is a fiction, existing only in the contemplation of the law.\(^9\) Like all legal

\(^7\) In the case of New York joint stock associations, while the statute (N.Y. Gen. Ass'ns Law § 17) permits an action to be brought against the members individually in the first instance, an action against the association as such is procedurally more convenient and is more common. N.Y. Gen. Ass'ns Law § 13. Hibbs v. Brown, 190 N.Y. 167, 82 N.E. 1103 (1907); National Bank v. Van Derwerker, 74 N.Y. 234 (1878). In jurisdictions which recognize the business or Massachusetts trust and where the trustees, being free of control of the beneficiaries, are not agents for the beneficiaries, limitation of liability of the beneficiaries may be obtained. Betts v. Hackathorn, 159 Ark. 621, 252 S.W. 692 (1923); Goldwater v. Oltman, 210 Cal. 408, 292 Pac. 624 (1930); Brown v. Bedell, 263 N.Y. 177, 188 N.E. 641 (1934); Magruder, The Position of Shareholders in Business Trusts, 23 Colum. L. Rev. 423 (1923); Stevens, Limited Liability in Business Trusts, 7 Cornell L.Q. 116 (1922).

\(^8\) Limitation of the personal liability of the stockholders rests entirely with the legislature which creates the corporation. One recent authority, Lattin, Corporations 151 (1959), describes limited liability as "a late comer in the corporation's list of attributes." Until the failure of many banks during the depression era of the 1930s, particularly the Bank of the United States in New York, the so-called "double liability" of stockholders in national and state banks was the rule. Section 6 of the former New York Bus. Corp. Law, N.Y. Sess. Laws 1909, ch. 12, provided that a corporation might become "a full liability corporation" by a statement to that effect in the certificate of incorporation. Even today individual stockholders may become jointly and severally liable to employees for wages and fringe benefits under certain circumstances. N.Y. Stock Corp. Law § 71; Rogers & McManus, Stockholders' Booby-Trap: Partnership Liabilities of Stockholders Under Section 71, New York Stock Corporation Law, 23 N.Y.U. L. Rev. 1149 (1953). The new N.Y. Bus. Corp. Law § 630 modifies § 71 principally by limiting the liability to the ten largest stockholders in non-public issue corporations and by giving them a right of contribution.

\(^9\) Coke's statement in Sutton's Hospital case is that "a corporation aggregate of many is invisible, immortal, and rests only in intendment and consideration of law." 10 Co. Rep. 23a 32b, 77 Eng. Rep. 960, 973 (K.B. 1612), see 1 Blackstone, Commentaries 476, and Chief Justice Marshall in Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 335, 408-09 (1819) where the same concept of a corporation is expressed. An extreme
fictions, when they fail to satisfy the purpose for which they have been devised, the corporate fiction is at times ignored by the courts and the corporate entity is disregarded. Such instances are the rare exception, however, so that the entity theory continues as the foundation of the law's approach to the day-to-day operation of the corporation. Contrariwise, the common-law concept of the unincorporated group, be it a partnership, joint venture, joint stock company or association, or a business trust, is that the group constitutes a mere aggregate of legal persons, coming into being, not by the fiat of the state operating through the legislature, but essentially through the agreement of the parties involved.

application of the fictitious nature of the corporate entity may be found in Eichner v. Bowery Bank, 24 App. Div. 63, 65, 48 N.Y. Supp. 978, 980 (1st Dep't 1897), in which a corporation was held not liable for slander because the "corporation itself could not talk." Later the same court, in holding that a corporation could be liable for slander, the act of its agent being ascribed to it, repudiated "the archaic doctrine" that a corporation, being an intangible legal fiction, had no physical powers, no mind to form an intent, or mouth to speak. Kharas v. Barron G. Collier, Inc., 171 App. Div. 388, 157 N.Y. Supp. 410 (1st Dep't 1916). See generally Farmers' Loan & Trust Co. v. Pierson, 130 Misc. 110, 222 N.Y. Supp. 532 (Sup. Ct. 1927); Dewey, The Historic Background of Corporate Legal Person-ality, 35 Yale L. J. 655 (1926); Machen, Corporate Personality, 24 Harv. L. Rev. 253 (1911).

10. Lattin, Corporations 60-96 (1959); Fuller, The Incorporated Individual: A Study of the One-Man Company, 51 Harv. L. Rev. 1373 (1938); Wormser, Piercing the Veil of Corporate Entity, 12 Colum. L. Rev. 496 (1912). For a specific instance see note 19 infra.

11. Wormser, The Disregard of the Corporate Fiction and Allied Corporate Problems 1-85 (1927). In Donnell v. Herring-Hall-Marvin Safe Co., 208 U.S. 267, 273 (1908), Mr. Justice Holmes said: "Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception. But to generalize is to omit, and in this instance to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and law. A leading purpose of such statutes and of those who act under them is to interpose a nonconductor, through which in matters of contract it is impossible to see the men behind." In that case the Supreme Court held that the agreement of a corporation which had sold all of its assets, including goodwill, to the plaintiff with a covenant not to compete, did not bind its stockholders (members of a family group), all of whom had notice of the agreement. More than fifty years later a substantially similar legal conclusion was reached on somewhat different facts in MacPherson v. Eccleston, 11 Cal. Rep. 671 (Dist. Ct. App. 1961).

12. Civil law jurisdictions by commercial code or judicial usage treat partnerships as legal persons. Puerto Rico v. Russell & Co., 288 U.S. 476 (1933); Empire Rice Mill Co. v. K. & E. Neumond, 199 Fed. 800 (E.D. La. 1912); Crane, The Uniform Partnership Act, a Criticism, 28 Harv. L. Rev. 762, 764 (1915). The common law looked upon the firm as an aggregate of individuals. Lindley, Partnership 4-5 (11th ed. 1950). The original draftsman of the Uniform Partnership Act, Dean Ames, was of the opinion that the law could be stated with greater degree of clarity and simplicity by regarding the partnership for most purposes as a legal person and his suggested definition of a partnership called it a "legal person." Dean Lewis who completed the project, upon the death of Dean Ames, reverted to the common-law definition of a partnership as "an association of two or more
The concession theory of a corporation nicely dovetailed with the fiction or entity theory. Since the corporation is "a mere abstraction of the law," it can be said to exist only by virtue of the law's source, i.e., the sovereign or state. Under the concession theory, therefore, the corporation is solely a creature of the state, existing only by the grant or concession of the state and subject entirely to the visitorial power of the state. The important point, for our purposes, is that the concession theory still remains as the foundation of modern American corporation law. This is so even though the corporate franchise is no longer the singular privilege, often monopolistic in design, which it once was, since the enactment of general incorporation laws makes incorporation readily available to all.

THE PURPOSE OF CORPORATION STATUTES

The policy behind modern corporation statutes, requiring the legislature's consent to incorporation and subjecting the corporation to certain rules and regulations in the conduct of its affairs, is obviously based upon a purpose to protect the state, the public, and the creditors and stockholders of the corporation. When, however, in particular instances it has appeared that such protection was not needed or intended to apply, the courts have, without much difficulty, found means of dispensing with adherence to the strict statutory norm. Defective incorporation was alleviated by the formulation of the de facto doctrine. Though the corporation, being a creature of limited powers, could exercise only those powers granted expressly or by implication, ultra vires transactions have...
been permitted.15 Although by statute a corporation must be managed by its board of directors,16 New York has allowed at least a slight impingement upon the broad provisions of the statutory norm, where the public, creditors, purchasers of stock, and minority stockholders are not damaged.17 Also, the required corporate formality of directors' action has been ignored in New York, at least in the case of the "family corporation."18 Further, the veil of corporate entity has on occasion been pierced by the courts, when it was considered just and desirable to disregard the fiction.19 Moreover, where the courts have failed to give a liberal interpretation to a statutory provision, the legislature has seen fit to accomplish the desired result.20 Finally, the courts, in ascertaining

15. Harris v. Independence Gas Co., 76 Kan. 750, 92 Pac. 1123 (1907); Stevens, Private Corporations § 72 (2d ed. 1949). The liberal suggestions of Mason, J., in the cited case have, in effect, been adopted in the new Business Corporation Law of New York where § 203 provides in effect that the claim of ultra vires shall not be available except in an action by a shareholder to enjoin a corporate act, or by or in the right of the corporation against an incumbent or former officer or director, or in an action or special proceeding by the attorney general.


19. See note 10 supra. It would be difficult to list, even by categories, all of the instances in which the corporate entity has been disregarded by the courts. However, there are certain fairly specific instances where the courts have "pierced the corporate veil," i.e., when the corporate device has been used: (a) to defraud creditors, In re Rieger, Kapner & Altmark, 157 Fed. 609 (S.D. Ohio 1907); Booth v. Bunce, 33 N.Y. 139 (1865); Montgomery Web Co. v. Dienelt, 133 Pa. 585, 19 Atl. 428 (1890); (b) to evade existing obligations, Dobbins v. Pratt Chuck Co., 242 N.Y. 106, 151 N.E. 146 (1926); cf. Berry v. Old South Engraving Co., 283 Mass. 441, 186 N.E. 601 (1933), 47 Harv. L. Rev. 135, 32 Mich. L. Rev. 551; (c) to evade a statutory prohibition, United States v. Reading Co., 253 U.S. 26 (1920); cf. Jenkins v. Moysie, 254 N.Y. 319, 172 N.E. 521 (1930); (d) to achieve monopoly, People v. North River Sugar Ref. Co., 121 N.Y. 582, 24 N.E. 834 (1890); State v. Standard Oil Co., 49 Ohio St. 137, 30 N.E. 279 (1892); (e) as a mere agency or instrumentality of another corporation, Ross v. Pennsylvania R.R., 106 N.J.L. 536, 148 Atl. 741 (Ct. Err. & App. 1930); cf. Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58 (1926); (f) as the alter ego of an individual or individual stockholders, Jackson v. M. H. Thomas Inv. Co., 46 F.2d 252 (5th Cir. 1931); B. Bressman, Inc. v. Mosson, 127 Misc. 282, 215 N.Y. Supp. 766 (App. T. 1926); (g) to operate a business without adequate capitalization, Luckenbach S.S. Co. v. W. R. Grace & Co., 267 Fed. 676 (4th Cir.), cert. denied, 254 U.S. 644 (1920). But see Bartle v. Home Owners Cooperative, Inc., 309 N.Y. 103, 127 N.E.2d 832 (1955). The question of the disregard of the corporate entity may arise in other situations, such as, the treatment to be accorded a creditor or stockholder in insolvency proceedings, Taylor v. Standard Gas & Elec. Co., 306 U.S. 307 (1930); Gannett Co. v. Larry, 221 F.2d 269 (2d Cir. 1955); or in determining a testamentary disposition. In re Winburn's Will, 136 Misc. 19, 240 N.Y. Supp. 208 (Surr. Ct. 1930).

20. The decision in Benintendi v. Kenton Hotel, Inc., 294 N.Y. 112, 60 N.E.2d 829 (1945) that a by-law requiring unanimity was in conflict with N.Y. Stock Corp. Law § 55
the intention of the parties to a contract\textsuperscript{21} or of the legislature,\textsuperscript{22} have given recognition to the realities of business life. The legislatures have done likewise, where insistence on the orthodox distinction between the corporation and the unincorporated group would defeat the legislative purpose.\textsuperscript{23}

**THE CLOSE CORPORATION**

Within recent years much attention has been paid by legal scholars to the so-called "close corporation." A definition of a close corporation which best suits the purposes of our discussion is found in Professor O'Neal's excellent and up-to-date work:

The term sometimes seems to be used to designate an incorporated enterprise in which the participants consider themselves partners \textit{inter se} and have tried by shareholders' agreement or otherwise to obtain for the enterprise one or more partnership advantages or attributes. Thus the close corporation has been characterized as a "chartered partnership," "incorporated partnership," and "a corporation \textit{de jure} and a partnership \textit{de facto}"; and it has been said to be functionally more closely related to the partnership than the corporation.\textsuperscript{24}

Within this definition there would be encompassed the so-called "joint venture corporation."\textsuperscript{25} Judge Desmond's characterization of the joint venture corporation as "one of the commonest of modern day business


21. Hartigan v. Casualty Co. of America, 227 N.Y. 175, 124 N.E. 759 (1919), involving the interpretation of an insurance policy in respect to coverage where the court said: "The partnerships in this case are not for all purposes to be regarded as legal entities, but for the purpose of ascertaining the intention of the parties to the policy herein, we are governed by common parlance rather than legal parlance." Id. at 179, 124 N.E. at 790. The court cites Bank of Buffalo v. Thompson, 121 N.Y. 280, 283, 24 N.E. 473, 474 (1890), to the effect that a mortgage executed by a member of a partnership to secure payment of all promissory notes made by him did not extend to a firm debt since "among business men a distinction is made between the firm, as an entity, and the members who compose it..."

22. Liverpool Ins. Co. v. Massachusetts, 77 U.S. (10 Wall.) 566 (1870), in which it was held that, although the English Parliament had specifically enacted that a joint stock company, formed under a deed of settlement, was not a corporation, it was to be treated as such for purposes of taxation. See also Hemphill v. Orloff, 277 U.S. 537 (1928).

23. For example, a statute may treat the partnership as a legal person for procedural purposes. See N.Y. Civ. Prac. Act § 222-a, providing that partners may sue or be sued in the firm name. In enacting tax legislation Congress has seen fit on occasion to depart from the traditional distinction between the corporation and the partnership. See Axelrad, Choice of Form: Partnership, Corporation, or In Between, 19 N.Y.U. 19th Inst. on Fed. Tax. 361 (1961); Maier & Wild, Taxation of Professional Firms as Corporations, 44 Marq. L. Rev. 127 (1960); Comment, 6 St. Louis U.L.J. 219 (1960); Note, 14 Ohio L. Rev. 99 (1961).


25. See note 2 supra.
arrangements" is well founded in fact. It has been used in the construction, railroad, mining, maritime, communications, electric power, petroleum, and other industries, as well as for the conduct of smaller and more modest enterprises. In the latter type of joint venture the fiduciary problem is more clearly presented and most of the New York cases involve close corporations with a few individual stockholders engaged in a relatively small venture.

One of the voids in American corporation statutes, certainly from the viewpoint of the practicing attorney, is the failure or inability generally of the state legislatures to afford distinct statutory treatment to the close corporation, as differentiated from the publicly owned corporation. Although a "Close Corporation Law" was proposed for New York in 1943, none has been enacted. The obvious reason for such failure has been the difficulty of differentiating, for the various statutory purposes, the close corporation from the public-issue corporation. A single step

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26. See note 4 supra.


29. Winer, Proposing a New York "Close Corporation Law," 28 Cornell L.Q. 313 (1943). The statutory definition of a close corporation proposed by Winer is "any stock corporation in which the stock is owned by not more than five persons who elect to incorporate under this law. The representatives of a decedent's estate shall for one year after his decease be deemed one person within the meaning hereof. Otherwise, whether the stockholder is a corporation, partnership, trustee, executor, administrator, nominee or any other representative, the number of persons beneficially interested as stockholders, partners, beneficiaries, legatees, principals, etc., shall be deemed the number of stockholders." Id. at 335-36. It is obvious that the latter part of this definition would exclude from the application of the proposed statute many incorporated partnerships and joint ventures. See also Note, Statutory Assistance for Closely Held Corporations, 71 Harv. L. Rev. 1498 (1958).

in that direction, although not expressed as such, was made in 1948.\textsuperscript{31} That step was extended much further by the recently enacted Business Corporation Law of New York\textsuperscript{32} providing that a written agreement between two or more shareholders with respect to voting rights is valid\textsuperscript{33} and further that, with consent of all shareholders, both present and future, a similar provision in the certificate of incorporation of a closely held corporation may be valid, even though it would otherwise be invalid as improperly restricting the discretion of directors in their management of corporate affairs, and that insofar as the provision is operative, the directors are relieved of normal directors' liabilities and the shareholders made subject thereto.\textsuperscript{34} The new statute also permits the shareholders to elect officers, where the certificate of incorporation so provides.\textsuperscript{35} The statute, however, does not attempt to distinguish precisely between a close corporation and one which is publicly owned;\textsuperscript{36} nor does it expressly touch on the basic problem which is the subject of this paper.

Much that has been written on the close corporation deals with the methods to obtain for the members thereof, within the framework of existing statutory provisions, the advantages and working arrangements peculiar to the partnership or joint venture and thus give legal effect to the realities of business life.\textsuperscript{37} A few such methods are: the concentration of defining the genuine close corporation for purposes of a statute has been found.\textsuperscript{7} Law Revision Comm'n, Recommendation and Study Relating to Requirements of Greater Than Majority or Plurality Vote of Directors or Shareholders 886 (1943). See also note 36 infra.

31. See note 20 supra, where the events leading to the enactment of N.Y. Stock Corp. Law § 9 are mentioned.


34. N.Y. Bus. Corp. Law § 620.

35. N.Y. Bus. Corp. Law § 715(b).

36. Senator Anderson, the Chairman of the Joint Legislative Committee to Study Revision of Corporation Laws, which drafted the new statute, and the Committee's Counsel, Robert S. Lesher, have stated: "An effort to balance the interests of shareholders, management, creditors and employees was made, tempered always by what was considered to be sound public policy. The statute also reflects an attempt to merge the interests of public issue corporations and closely held corporations. An early decision was made by the Committee that separate laws governing these different categories of corporations were not feasible. The statute therefore has had to blend provisions which were primarily applicable to the large unit with those which were essentially designed to apply to the small unit. The degree to which the law will accomplish these blendings must await the decision of time." 33 N.Y.S.B.J. 303, 310 (Oct. 1961).

of management in one or more stockholders which is obtained by the use of voting and non-voting stock, the voting trust, or a stock pooling arrangement; a requirement of unanimity for action by the stockholders or directors; the attainment of *delectus personae*, which is basic to partnerships, by placing restrictions on the transferability of stock; and the resolution of deadlocks by arbitration. The all-important point to recognize is that all such devices and arrangements, where permitted by statute, are designed to operate exclusively between or among the stockholders and are not intended to, and cannot, affect or limit the essential concept that the enterprise is legally a corporation so far as the state, the public or the corporate creditors are concerned.

The Problem

The relatively limited question we will consider is whether a fiduciary or confidential relationship may exist between or among the stockholders of the so-called incorporated partnership or joint venture? The problem can best be understood by considering a hypothetical controversy which such a close relationship may engender: A and B, who are partners or joint adventurers (or who are about to become such) in the business of owning and operating an office building, decide to incorporate to obtain limitation of liability, or some tax benefit. All the stock of the corporation is issued to A and B equally. A supplied most of the capital and B, who is experienced in real estate operations and management, furnished the business acumen. A, B, and C, an employee of the enterprise, are the directors and officers of the corporation. After a period of time B learns that the office building can be sold at a large profit and, without disclosing that fact to A, purchases A's stock and thereafter sells the office building or all of the stock in the corporation at a large profit.

If A and B had remained partners or joint adventurers without incorporating they would have been fiduciaries in respect to each other and there would be little question that A could legally compel B to account for A's share of the profits. Under the common law of a

38. For our purposes it makes no difference whether the parties are partners or joint venturers. See note 2 supra; McIver v. Norman, 187 Ore. 516, 213 P.2d 144 (1949). In Meinhard v. Salmon, 249 N.Y. 458, 463-64, 164 N.E. 545, 546 (1928), Judge Cardozo made his much quoted statement: "Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."

minority of jurisdictions, or where federal statutes and regulations apply, B might, under the facts assumed, have been accountable as a stockholder-director for his failure to make full disclosure. The majority of jurisdictions would undoubtedly hold B accountable without regard to the fact that he was also a director, on the ground that, despite the incorporation of their business venture, A and B had remained fiduciaries in respect to each other. A contrary result is implicit in the opinions expressed by the New York Court of Appeals in the Weisman case and by most of the lower New York courts.

The New Jersey case of Jackson v. Hooper appears to be the leading case on the general subject. The New York Court of Appeals strongly relied upon this decision in the Weisman case, as have many of the lower New York courts and the courts of the jurisdictions which are in general accord with the predominant view in New York.

Jackson v. Hooper

The bill in Jackson v. Hooper, alleged that the plaintiff and the principal defendant had for some years been engaged in the business of

N.Y. 402, 167 N.E. 514 (1929); Meinhard v. Salmon, supra note 38; Selwyn & Co. v. Waller, 212 N.Y. 507, 106 N.E. 321 (1914); Reuschlein, Cases on Partnership and Unincorporated Business 118 (1952). Of course, the case for relief is stronger where there is not merely concealment but positive misrepresentation. Seligson v. Wees, 222 App. Div. 634, 227 N.Y. Supp. 338 (1st Dep't 1928).

40. Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903); Hitchkiss v. Fischer, 136 Kan. 530, 16 P.2d 531 (1932); 46 Harv. L. Rev. 847 (1933). These cases hold that the director-stockholder owes a fiduciary duty of disclosure to the selling stockholder. The older, and apparently, majority view holds to the contrary. Board of Commissioners v. Reynolds, 44 Ind. 509 (1873), following Carpenter v. Danforth, 52 Barb. 531 (N.Y. Sup. Ct. 1859); see Gladstone v. Murray Co., 314 Mass. 554, 50 N.E.2d 958 (1943). Courts, not committed to the minority view, may hold the purchaser accountable where there are special circumstances requiring disclosure. Strong v. Repide, 213 U.S. 419 (1909). See generally Walker, The Duty of Disclosure by a Director Purchasing Stock From His Stockholders, 32 Yale L.J. 637 (1923).

41. Securities Exchange Act of 1934 § 10(b), 48 Stat. 891, 15 U.S.C. § 78j(b) (1958); S.E.C. Rule X-10B-5, 17 C.F.R. § 240.10b-5 (Supp. 1961). In Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947) the court directed the individual defendants in a close corporation to account, holding that, although the federal statute and the rule, by their language, were no more than prohibitory, the existence of a civil remedy based on concealment was implicit. The statute, by its terms, applies where interstate commerce or the mails are used in connection with the purchase and is not limited to securities traded on a national exchange or in the over-the-counter market. Hence, the federal legislation may apply to a private transaction such as is assumed in the text. See Northern Trust Co. v. Essaness Theatres Corp., 103 F. Supp. 954 (N.D. Ill. 1952); Speed v. Transamerica Corp., 99 F. Supp. 503 (D. Del. 1951); Latty, The Aggrieved Buyer or Seller or Holder of Shares in a Close Corporation Under the S.E.C. Statutes, 18 Law & Contemp. Prob. 505, 505 (1953).

42. 76 N.J. Eq. 592, 75 Atl. 568 (Ct. Err. & App. 1910), reversing 76 N.J. Eq. 185, 74 Atl. 130 (Ch. 1909).
selling subscription books in England. They dealt with two individuals named Clarke who operated an English corporation. Jackson and Hooper had acquired the Clarke interests in the business and had entered into an agreement between themselves which, in effect, provided that so long as they were associated in business they would conduct the same by mutual assent. It was also agreed that their ownership interests and control in management would be equal, except that either might act alone in the routine conduct of the business in the absence of the other. The plaintiff alleged that he and Hooper had liquidated the Clarke corporation for tax reasons and that they eventually organized in its place an English corporation and an Illinois corporation. They owned the new corporations in equal shares, except for nominal shares which were held by the other three defendants to qualify them as directors in each corporation. The plaintiff and the principal defendant withdrew the profits in equal amounts and made use of the two corporations as mere agencies for carrying out the plans which they agreed upon from time to time. Jackson and Hooper also conducted large and important transactions in their individual names without the aid of the corporations. Jackson alleged that disagreements arose and that the defendants excluded him from the conduct of the business which they turned over to Hooper. As a result of Hooper's mismanagement and waste and the unnecessary disposition of assets, it was alleged that the business was threatened with destruction.

The relief demanded was a dissolution of the partnership, an accounting of its affairs and an injunction to restrain the defendants from disposing of the qualifying shares and from withdrawing assets from the business or from excluding the plaintiff therefrom.

The case came before the Vice Chancellor on an application for a preliminary injunction. He found that the facts alleged did not constitute a partnership because of the lack of mutual agency, but rather that there was a joint venture. The Vice Chancellor found as a matter of law, however, that the same rules of law apply to partnerships and joint ventures and that the plaintiff and defendant were fiduciaries in respect to each other. The Vice Chancellor thereupon granted a preliminary injunction sufficient to hold the status quo without interfering with the ordinary, regular and usual conduct of the business.

The Prerogative Court of New Jersey reversed on the ground that the chancery court lacked power to enforce the agreement. The ratio decidendi of the court's opinion has been often quoted by other courts, particularly those of New York. It deserves full quotation here:

The law never contemplated that persons engaged in business as partners may incorporate, with intent to obtain the advantages and immunities of a corporate form and then, Proteus-like, become at will a copartnership or a corporation, as the exigencies or purposes of their joint enterprise may from time to time require.
The policy of the law is to the contrary. If the parties have the rights of partners they have the duties and liabilities imposed by law and are responsible in solido to all creditors.

If they adopt the corporate form, with the corporate shield extended over them to protect them against personal liability, they cease to be partners and have only the rights, duties and obligations of stockholders. They cannot be partners inter sese and a corporation as to the rest of the world.

Furthermore, upon grounds of public policy, the doctrine contended for cannot be tolerated as it renders nugatory and void the authority of the Legislature—a co-ordinate branch of the government—established by the Constitution, in respect to the creation, supervision, and winding up of corporations.\(^\text{43}\)

The court also found that the injunction granted by the Vice Chancellor did in substance and effect regulate and control the internal affairs of two foreign corporations, even though it purported merely to enjoin the individual defendants from transferring property of the business.

Let us prescind for the moment from a consideration of the last paragraph of the above quotation and analyze the validity of the statements made in the balance of the quoted part of the court's opinion.

Reduced to its simplest terms the court states that limitation of personal liability and the continuance of a fiduciary relationship are legally incompatible. This appears also to be Judge Conway's appraisal of the quotation, part of which he repeated in his opinion in the Weisman case, where he followed the quoted portion with the following statement:

What we do declare is that when individuals do determine to conduct business through a corporation, as is here alleged, they are not at one and the same time joint venturers and stockholders, fiduciaries and nonfiduciaries, personally liable and not personally liable. . . .

Inasmuch as it is not possible for individuals to carry on a joint venture through the instrumentality of a corporation, no confidential or fiduciary relationship can be said to exist between the parties and the equitable relief of an accounting is not available to plaintiffs.\(^\text{44}\)

At this point we are concerned with the validity of the broad basic assumption made by both courts in the quoted portions of their respective opinions, \(i.e.,\) that a dual legal relationship may not exist between or among members of an incorporated partnership or joint venture. Our conclusion is that such a postulate is a mere \textit{ipse dixit}, a generalized assumption without reason or precedent to support it and that no policy of the law exists which would preclude legal recognition of the dual incidents of limitation of liability and a fiduciary relationship.

Neither court points to any specific interdicting policy of the law;\(^\text{45}\)

\(^{43}\) 76 N.J. Eq. at 599, 75 Atl. at 571.

\(^{44}\) 3 N.Y.2d at 449-50, 144 N.E.2d at 418, 165 N.Y.S.2d at 750.

\(^{45}\) "The interest of shareholders in organizing a profitable venture should coincide with the state's interest in promoting economically efficient enterprises, and as long as the
nor does there appear to be any general or public policy of the state involved.\textsuperscript{46} We may concede that in return for the privilege of incorporation, including freedom from personal liability, the state demands "that the entity take a prescribed form and conduct itself, procedurally,

arrangements do not affect creditors or other outsiders, there seems to be no reason for denying the privilege of limited liability." Note, 71 Harv. L. Rev. 1498, 1504 (1958). In this respect the situation is unlike those cases where the courts have declared invalid stockholders' agreements which contravene an essential part of the legislative policy as expressed in a specific statutory provision, such as the mandate that a corporation shall be managed by its board of directors. Comment, 17 Fordham L. Rev. 95 (1948). Of course such invalid agreements may, and sometimes do, exist in the case of the close corporation, particularly the incorporated partnership or joint venture.

\textsuperscript{46} Despite its often general and indiscriminate use, the somewhat amorphous term "public policy," when appealed to in the resolution of legal questions is nothing more than a synonym for the law. Vidal v. Girard's Ex'r, 43 U.S. (2 How.) 126, 197-198 (1844): "Nor are we at liberty to look at general considerations of the supposed public interests and policy of Pennsylvania upon this subject, beyond what its constitution and laws and judicial decisions make known to us. The question, what is the public policy of a state, and what is contrary to it, if inquired into beyond these limits, will be found to be one of great vagueness and uncertainty, and to involve discussions which scarcely come within the range of judicial duty and functions, and upon which men may and will complexionally differ . . . We disclaim any right to enter upon such examinations, beyond what the state constitutions, and laws, and decisions necessarily bring before us." To the same effect see Swann v. Swann, 21 Fed. 299, 301 (E.D. Ark. 1848); People v. Hawkins, 157 N.Y. 1, 12, 51 N.E. 257, 260 (1898). See also Cardozo, The Growth of the Law (1924); O'Meara, Natural Law and Everyday Law, 5 Natural L.F. 83 (1960); Winfield, Public Policy in the English Common Law, 42 Harv. L. Rev. 76 (1928). A recent decision of the New York Court of Appeals is pertinent. N.Y. Membership Corp. Law § 10 requires a Supreme Court Justice to approve a certificate of incorporation of a non-profit corporation before it is filed with the Secretary of State. For many years Supreme Court Justices have assumed that such judicial approval required "a finding that the objects and purposes of the proposed incorporation are in accord with public policy . . . and not injurious to the community." In the Matter of Daughters of Israel Orphan Aid Soc'y, 125 Misc. 217, 219, 210 N.Y.S. 541, 543-44 (Sup. Ct. 1925). In reversing a judicial disapproval of a certificate of incorporation and in holding that the function of judicial scrutiny as intended by the legislature was to ascertain whether the proposed incorporation was for a lawful purpose, the court of appeals said in reference to the cited decision: "Since the case cited was decided in 1925, many decisions have followed its reasoning, in effect that a Justice is at liberty to grant or deny applications based on his personal notion of what is contrary to public policy or injurious to the community. We feel impelled to hold these views erroneous. In the first place the public policy of the State is not violated by purposes which are not unlawful. To hold otherwise would be a contradiction in terms. In the second place the test as to what may be injurious to the community is too vague, indefinite and elusive to serve as an objective judicial standard. Within such a scope the individual Justice would be at liberty to indulge in his own personal predilections as to the purposes of a proposed corporation, and impose his own personal views as to the social, political and economic matters involved." Association for the Preservation of Freedom of Choice v. Shapiro, 9 N.Y.2d 376, 382, 174 N.E.2d 487, 489, 214 N.Y.S.2d 388, 391 (1961); see Vance, Freedom of Association and Freedom of Choice in New York State, 46 Cornell L.Q. 290 (1961); Note, 55 Colum. L. Rev. 380, 394 (1955).
INCORPORATED PARTNERSHIPS

according to fixed rules. Nevertheless, the statutory scheme governing corporations nowhere prohibits stockholders from reposing trust and confidence in each other. The fact is that stockholders in close corporations often do just that. No policy of the law prescribes such conduct. Certainly not the policy which induced the legislature to grant immunity from personal liability to stockholders of all types of corporations, whether such stockholders are many or few. Such immunity is not really essential to corporateness and has been attained in other forms, both with and without legislative sanction.

It is difficult to perceive how a relationship of trust and confidence between stockholders can have any relevancy whatsoever on the question of their liability to corporate claimants, except when such close relationship is accompanied by something entirely separate from, and not germane to, the fiduciary concept, namely, the disregard by the stockholders themselves of corporate formalities and amenities. In the context in which we are discussing it, the fiduciary concept pertains solely to the relation of the stockholders inter se. The presence or absence of personal liability of the stockholders depends upon other factors having nothing to do with that relationship. Granted the existence of a corporation de jure or de facto, creditors of the corporation have recourse solely to corporate assets, unless there are grounds for piercing the corporate veil. The existence of a fiduciary or confidential relationship between or among the stockholders is not per se a ground for disregarding the corporate entity and may exist with complete observance of all of the statutory rules, procedural or otherwise, which govern the corporation.

It should be observed that in nearly all of the cases in which a stockholder of a corporation has attempted to enforce a fiduciary obligation claimed to be due from another stockholder, the complaining stockholder has taken the direct approach, utilized in Jackson v. Hooper and in the Weisman case—alleging that he and the other stockholders were in fact

47. Benintendi v. Kenton Hotel, 294 N.Y. 112, 118, 60 N.E.2d 829, 831 (1945). "The stockholders of a corporation may be the real owners of the corporation, but their right to control the corporation is governed by the law of its creation." In the Matter of Am. Fibre Chair Seat Corp., 265 N.Y. 416, 420, 193 N.E. 253, 255 (1934).

48. See note 8 supra.

49. The legislature grants limitation of liability to certain partners in limited partnerships. Uniform Limited Partnership Act § 7. In Pennsylvania general partnerships may obtain limited liability by filing as a registered partnership or a partnership association under the applicable statutes. Comment, 2 Vill. L. Rev. 385 (1957).

50. See the discussion of the business trust in note 7 supra.

51. The risk of this happening is obviously more likely where, as in Jackson v. Hooper, the so-called "partners" or "joint adventurers" see fit to use the corporate device as a mere instrumentality, without sufficient observance of the corporate entity. See notes 10 & 19 supra.
partners or joint adventurers. This approach is understandable in the
light of the tendency of most lawyers to fit relations into certain well
defined legal categories designated by a recognized nomenclature. Such
an approach has afforded those courts following the lead of *Jackson v.
Hooper* the opportunity to deny relief upon the simple, and superficially
plausible ground that persons may not legally at the same time be
partners or joint adventurers on the one hand and stockholders on the
other, in respect to the same business enterprise. Taken by itself such a
holding is technically correct. With regard to the state, the public,
corporate creditors, and other stockholders, if any, the so-called “part-
ners” or “joint adventurers” are not really such but are legally stock-
holders in a corporation. This the plaintiff cannot deny. What the
plaintiff means to assert is that, insofar as the particular matters in
dispute are concerned, he and his fellow stockholder, as between them-

selves, should be treated by the court as though they were partners or
joint adventurers. The dispute might better be presented, without
reference to a more specific legal nomenclature, by the mere allegation
of the existence of a confidential or fiduciary relationship and the
consequent obligation which has been violated.

Unquestionably partners and joint adventurers are fiduciaries in
respect to each other. The fiduciary concept, however, is extremely broad
and it may not be going too far, at least in describing the source of such
duties as those of full disclosure and loyalty, to say that a fiduciary is
really anyone in whom another rightfully reposes trust and confidence.52

In the case of stockholders in a close corporation the fiduciary relation
may arise by virtue of an express agreement, as was the case in *Jackson
v. Hooper*, or it may exist by inference of fact, as in the case where
partners decide to incorporate primarily for tax, limitation of liability,
or other reasons of business convenience. It should not, however, be
presumed that, merely because the stockholders in a close corporation
formerly conducted the business as partners or joint adventurers, they
intend the fiduciary relation to continue after incorporation. Nor should
it be implied that all stockholders in a close corporation are automatically
fiduciaries as to each other. This is true even of a close family corpo-
ration. Each case must be determined on its own facts, and it may very
well be, and often is the fact that stockholders in a close corporation,
all members of a single family or formerly partners, have intended upon

52. “The exact limits of the term ‘fiduciary relation’ are impossible of statement. Equity
refuses to bind itself by an all-inclusive definition. It reserves entire freedom to declare
relationships to be fiduciary upon the particular facts of each case.” Bogert, Trusts and
Trustees § 481, at 127-28 (2d ed. 1960); see Tarloff v. Karanjeff, 17 Ill. 2d 462, 162 N.E.2d
1 (1959); Duane Jones Co. v. Burke, 306 N.Y. 172, 117 N.E.2d 237 (1954). When exer-
cising control the majority of stockholders are said to be fiduciaries to the minority. Com-
incorporation of the business enterprise to occupy a strictly arm's length attitude toward each other. Nevertheless, in many cases circumstantial evidence may strongly suggest the existence of the confidential relationship. For example, the sole stockholders in a close corporation may be a business-wise son and his aged, widowed mother. Should the result reached in the well known case of Meinhard v. Salmon have been any different, if the joint adventurers there had seen fit to incorporate?

The courts should have no hesitancy in declaring the confidential relationship where it is found in fact to exist, even though the parties happen to be stockholders, and to grant the relief requested, to the extent that it will not contravene the statutory scheme governing corporations. Relief, by way of an accounting by B to A of the illegally obtained profit, would appear to be appropriate in the hypothetical case mentioned earlier. No obstacle in the statutory scheme governing corporations appears to prevent the interposition of a court of equity in granting such relief. Certainly the state is not concerned and corporate creditors are not involved. The dispute is one solely between A and B. The grant of relief is a simple matter of equity jurisdiction without regard to the law pertaining to corporations, partnerships, or joint ventures.

However, the solution may not be so clear when the relief sought goes beyond a simple accounting of an illegally obtained profit. In Jackson v. Hooper the bill requested, in addition to an accounting, an injunction and a dissolution of the alleged partnership. While an accounting, complicated though it would have been, might have been had between the parties, the other relief sought could well have contravened the statutory scheme governing corporations. The New Jersey court held, in Jackson v. Hooper, that the injunction should be refused because of the general proposition that a court will not ordinarily interfere in the internal affairs of a foreign corporation. The New Jersey court also properly found that Jackson and Hooper did not legally constitute a partnership or joint venture. Accordingly it was held that the chancery court lacked jurisdiction to proceed as though no corporation existed and to enter a decree dissolving their relationship as to partnership or joint venture. Jackson and Hooper were in fact stockholders in two foreign corporations and the dissolution of such corporations must follow the statutes. Generally, the law respecting the dissolution of a corporation on the one hand and that of a partnership on the other hand are quite

53. 249 N. Y. 458, 164 N. E. 545 (1928); see note 38 supra.
54. Note, 29 Colum. L. Rev. 965, 969 (1929), where it is stated: "However, it is now generally recognized that this limitation on the powers of courts of equity in suits against foreign corporations is not based upon any jurisdictional disability but rests upon grounds of policy and expediency." See Burnrite Coal Briquette Co. v. Riggs, 274 U.S. 203, 212-13 (1927); Cuppy v. Ward, 187 App. Div. 625, 176 N. Y. Supp. 233 (1st Dep't), aff'd mem., 227 N. Y. 603, 125 N. E. 915 (1919).
dissimilar. Partners can dissolve a partnership at will even though such dissolution constitutes a breach of the partnership agreement. Under existing New York law a corporation cannot be dissolved at the mere will of certain stockholders. Also corporate dissolution may be denied in circumstances where a court of equity might decree dissolution of a partnership. Nevertheless, in the case of a closely held corporation, where the rights of creditors are not involved, a court of equity should be permitted to afford appropriate relief akin to corporate dissolution where the circumstances require it.

It is undoubtedly true, therefore, that many of the cases in which relief was denied were properly decided upon the facts presented and the extensive relief requested. However the majority of New York cases, relying on the broad assumption that limitation of shareholder liability is incompatible with the existence of a confidential or fiduciary relationship, have concluded that no relief whatsoever should be allowed. It is with the latter group of cases that the writer takes issue.

55. See N.Y. Partnership Law § 62(2); Uniform Partnership Act § 31(2). The new Business Corporation Law of New York provides in section 1105 that the certificate of incorporation, if authorized by all shareholders, may provide that any shareholder or a certain number may enforce dissolution at will or upon the occurrence of any specified event.

56. See Uniform Partnership Act § 32(1)(c), (e), (f). N.Y. Partnership Law § 63(1)(c), (e), (f) provides that a court may decree dissolution of a partnership when "a partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business . . . " or when "the business of the partnership can only be carried on at a loss . . . " or when "other circumstances render a dissolution equitable." While Section 103 of the N.Y. Gen. Corp. Law provides for dissolution by the court in case of deadlock among shareholders or directors, section 117 requires that a court-decreed dissolution be beneficial to the stockholders and not injurious to the public. In In the Matter of Radom & Neidorff, Inc., 307 N.Y. 1, 119 N.E.2d 563 (1954), dissolution in the case of a deadlock was denied upon the ground that the corporation was functioning actively and with a profit. See Israels, The Sacred Cow of Corporate Existence, Problems of Deadlock and Dissolution, 19 U. Chi. L. Rev. 778 (1952); Note, 27 N.Y.U.L. Rev. 300 (1952). The holding in the cited New York decision will be nullified when the new Business Corporation Law, supra note 6, goes into effect on April 1, 1963. Section 1104 permits a court to dissolve a corporation when there is a deadlock among the directors or stockholders or where there is such internal dissension that dissolution would be beneficial, and section 1112 provides that in such a case "dissolution will not be denied merely because it is found that the corporate business has been or could be conducted at a profit."

57. hornstein, A Remedy For Corporate Abuse—Judicial Power to Wind up a Corporation at the Suit of a Minority Stockholder, 40 Colum. L. Rev. 220, 239 (1940). Lattin, Corporations 557-58 (1959), points out that while the weight of authority does not yet recognize the inherent power of equity to dissolve a corporation without statutory aid, there is a noticeable trend, since the turn of the century, toward recognizing the power of a court of equity to grant relief in proper cases. See also Kay v. Key West Dev. Co., 72 So. 2d 786 (Fla. 1954); Levant v. Kowal, 350 Mich. 232, 86 N.W.2d 336 (1957) (the court decreed that a corporation's property be sold and the money distributed to the two equal owners who were deadlocked, leaving the shell of the corporation to exist).
Before reaching any recommendation on how the decisional or statutory law of New York should be changed to conform to what appears to be the more enlightened view of the majority of jurisdictions, an examination of the New York decisions and of some outstanding decisions representing the majority view is in order.

New York Decisions

In many of the cases the court's expression of the opinion that persons may not at one and the same time be stockholders and partners or joint venturers was unnecessary to the actual decision. Three decisions ignore that broad assumption announced in *Jackson v. Hooper* and grant relief. The remaining decisions appear to have been based to some extent upon the doctrine of *Jackson v. Hooper*.

First we will consider decisions where the doctrine of *Jackson v. Hooper*, though referred to, was not actually necessary to the decision. It is certainly arguable that what was said in the majority opinion of the court of appeals in the *Weisman* case, quoted earlier, was unnecessary to the disposition of the appeal, which was from a dismissal of a complaint. The complaint alleged a joint venture between plaintiff and two of the individual defendants for the sale, distribution and exploitation of the products of the corporate defendant through a new corporation (also


named as a plaintiff), forty per cent of whose stock was issued to the individual defendants and the balance to the plaintiff; that plaintiffs devoted their best efforts to the distribution and exploitation of the products and that, thereafter, the corporate defendant notified plaintiffs that the corporate plaintiff would no longer be permitted to distribute the products which would henceforth be distributed by certain of the defendants. The complaint demanded judgment restraining the defendants from distributing the products except through the plaintiffs pursuant to the joint venture agreement and that defendants account to plaintiff for profits arising out of distribution after the notification date.

In addition to holding the joint venture agreement to be unenforceable under the doctrine of *Jackson v. Hooper*, the majority held that the agreement was terminable at will. Judge Fuld concurred with the majority on this single ground. Judge Desmond, in dissenting on all scores, was of the opinion that the joint venture, having no fixed term, continued until its purpose was accomplished.62

In the earlier case of *Drucklieb v. Sam H. Harris, Inc.*,63 the complaint in equity alleged an agreement between the plaintiff and one Harris to form a corporation, the plaintiff to invest cash and Harris to transfer to the corporation certain assets including good will. The agreement, it was alleged, further provided that plaintiff was to be employed as an officer of the corporation at a specified annual salary and that, if he were not so employed, Harris would purchase plaintiff's stock at book value. The complaint further alleged that Harris and his son as directors voted to reduce the value of the good will to a nominal amount in order to induce plaintiff to sell his stock at less than its true value. The relief demanded was that the defendants, including the corporation, be directed to restore the books of account to their original condition and that the corporation be enjoined from changing its books to reduce the book value of the stock.

Special term and the appellate division overruled defendants' demurrer to the complaint, the majority of the appellate division finding no difficulty in the fact that the relief sought a change in the corporate books, since the corporation was "in effect nothing more than an incorporated copartnership, in which the stockholders owe to each other much the same obligations of fair dealing that one copartner bears to another."64 In unanimously reversing, the court of appeals held (1) that the agreement

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62. See *Brock v. Poor*, 216 N.Y. 387, 111 N.E. 229 (1915), which is relied upon by the court of appeals in the Weisman case and in other New York decisions. It cited *Jackson v. Hooper* merely for the proposition that an undissolved corporation's existence could not be disregarded, even though it was alleged to be inactive and practically dead.


64. *155 App. Div. 83, 89, 140 N.Y. Supp. 60, 64* (1st Dep't 1913).
was not binding upon the corporation and did not justify the intervention of a court of equity in the control of the books of the corporation, and (2) that, no breach of the employment agreement having occurred, the action was premature. In commenting upon the appellate division’s statement that the corporation was nothing more than an incorporated partnership, the court of appeals refused to

assent to that doctrine in its full scope and entirety. Persons forming a corporation thereby gain many immunities and privileges of which they are not possessed as members of a partnership. Then liability for the debts and obligations of the business is limited and the death of one of the members does not work a dissolution of the corporation, as it does in the case of a partnership. For these privileges the parties have to pay a price. They have not the same unrestricted control and management of their enterprise as they would have as partners.65

The above quoted portion of the opinion was clearly not necessary in view of the courts finding that the action was premature.

Similarly in Cuppy v. Ward,66 although the court referred to the Jackson case, it refused to grant the relief requested, principally upon the ground that this would require the court’s interference in the internal management of a foreign corporation. Again in Berger v. Eichler67 and Claude Neon Lights, Inc. v. Federal Elec. Co.,68 it was unnecessary for the courts to rely on the doctrine of Jackson v. Hooper. In Berger the appellate division made new findings of fact and concluded that there was no fraud or concealment as the plaintiff had alleged, while in Claude Neon Lights, Inc. the court found that the agreement between plaintiff and defendant actually permitted the sale of stock by the defendant.

Several of the New York decisions appear to have relied directly upon the doctrine of Jackson v. Hooper.69

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65. 209 N.Y. 211, 102 N.E. 599 (1913).
69. Epstein v. Leibner, 258 App. Div. 1073, 18 N.Y.S.2d 11 (2d Dep’t) aff’d mem., 284 N.Y. 717, 31 N.E.2d 195 (1940); Boag v. Thompson, 203 App. Div. 132, 203 N.Y. Supp. 395 (2d Dep’t 1924). In Cohen v. Mahoney, 160 Misc. 196, 259 N.Y. Supp. 892 (Sup. Ct. 1936) the justice at special term gave effect to the corporate existence, even though, because of the failure to file the certificate of incorporation in the county clerk’s office, there was not even a de facto corporation formed. See Brooks Clothing Co. v. Flynn, 22 App. Div. 546, 250 N.Y. Supp. 69 (1st Dep’t 1931), which resulted in the amendment of Section 8 of the N.Y. Gen. Corp. Law to provide that corporate existence shall commence immediately upon filing the certificate with the secretary of state, upon whom was placed the duty of filing a certified copy in the county clerk’s office. The same justice in a later case, Miller v. Danziger, 91 N.Y.S.2d 655 (Sup. Ct. 1949), admitted that views and expressions, if not holdings, of the New York courts, are inconsistent with the doctrine of Jackson v. Hooper, citing Modlin v. Licht, 224 App. Div. 614, 231 N.Y. Supp. 265 (2d Dep’t 1928), aff’d mem., 252 N.Y. 589, 170 N.E. 154 (1929); Cuppy v. Ward,
Manacher v. Central Coal Co.\textsuperscript{70} deserves special mention. The amended complaint sought a declaratory judgment that a joint venture agreement had been established and maintained among three brothers and that the defendant brothers had breached the agreement and their fiduciary duty by acquiring an additional interest in the joint enterprise, conducted through various corporations, without giving the plaintiff an equal opportunity to participate. The amended complaint also requested an accounting. The majority of the appellate division held (1) that the amended complaint failed sufficiently to allege a joint venture agreement, and (2) that, even if it did, the amended complaint was legally insufficient under the doctrine of Jackson v. Hooper. The majority attempted to distinguish certain decisions,\textsuperscript{71} considered to be superficially in conflict with the doctrine on the ground that these decisions in one form or another enunciate the rule that a court of equity will intervene and grant relief where the agreement is extrinsic to the corporate entity. Relief is afforded the plaintiff not in his capacity as a stockholder but based upon an agreement derived from outside of the separate fictional existence of the corporation. Simply stated, the agreement or other factual situation upon which relief is granted runs alongside of the path of the corporation. When the two merge, however, and relief is sought upon the ground that the corporation has become a mere agency or instrumentality for the performance of an independent agreement of joint adventurers or partners the aggrieved party is relegated to his rights as a stockholder and may not sue in his individual capacity.\textsuperscript{72}

While the cases referred to by the majority involve for the most part agreements in reference to the stock of corporations, such factual distinction\textsuperscript{73} does not appear to furnish a sufficient basis to justify the application of any different legal principle. In these, and the types of factual situations which we have been considering, the fiduciary relationship exists and a court of equity should enforce the obligations arising therefrom, so long as no statute contravenes. In any event it is difficult to perceive, in the case before the court, what would be plaintiff's "rights as a stockholder" as distinct from those "in his individual capacity."

\textsuperscript{71} 187 App. Div. 625, 176 N.Y. Supp. 233 (1st Dep't), aff'd mem., 227 N.Y. 603, 125 N.E. 915 (1919).
\textsuperscript{72} 284 App. Div. at 385, 131 N.Y.S.2d 671 at 675-76; see Note, 55 Colum. L. Rev. 419, 421 (1955), stating in regard to the majority opinion that the "'extrinsic' distinction offered by the court appears to be without meaning. . . ."
\textsuperscript{73} Special term, in dismissing the original complaint, 125 N.Y.S.2d 260 (Sup. Ct. 1953), pointed to this distinction.
The gravamen of the complaint was that the defendants breached the agreement by acquiring additional and controlling stock in the joint enterprise without giving the plaintiff an opportunity to participate. Surely this alleged the violation of a purely personal right.\textsuperscript{74}

Three decisions of the New York courts in granting relief appear to ignore entirely the doctrine of \textit{Jackson v. Hooper}.

\textit{Modlin v. Licht}\textsuperscript{75} is practically on all fours with our hypothetical case of A and B. Plaintiffs and defendants entered into a real estate speculation and organized a corporation which took title to the real property, the corporate stock being divided among the parties. After having induced the other parties to sell him certain lots, one of the defendants made overtures to buy the remaining lots by offering the plaintiffs a ten per cent profit for their stock, without revealing that he was negotiating to sell the lots. In reversing the judgment in the court below, which held that the defendant owed no duty of disclosure, the court stated that the parties were essentially joint adventurers and, as such, owed the duty of utmost good faith to each other and were accountable for secret profits. The court further stated that in the case of dishonesty the court would look behind the corporate form and consider the parties in their real relation. While the court did refer to certain positive misrepresentations, the question argued on appeal, as stated by the court itself, was whether the defendants owed a fiduciary duty of disclosure.\textsuperscript{76}

\textit{Stuts v. Stuts},\textsuperscript{77} while not citing \textit{Modlin v. Licht}, appears to be in accord.

\textit{Macklem v. Marine Park Homes, Inc.}\textsuperscript{78} is significant and could possibly indicate a departure by the New York courts from the broad assumption of \textit{Jackson v. Hooper} adopted by the court of appeals in the \textit{Weisman} case. Plaintiff's assignor had a contract to purchase real property, but had insufficient funds to complete the purchase. The two

\textsuperscript{74} One justice dissented on the grounds (1) that the amended complaint sufficiently alleged a joint venture, and (2) that joint venturers may organize a corporation to implement their joint venture, remaining inter se joint venturers but a corporation to the rest of the world.


\textsuperscript{76} In reversing, the appellate division directed judgment in favor of the plaintiffs for the equitable relief demanded in the complaint which was merely to set aside the sale of the stock and to direct a retransfer of the shares. Assuming that no rights of third persons would be affected and that the defendants had completed the sale of the lots (which an examination of the record on appeal indicated was the case), it would seem the court could have granted the more direct relief in the form of an accounting of the profit on the sale, as was done in \textit{McManus v. Durant}, 168 App. Div. 643, 154 N.Y. Supp. 589 (1st Dep't 1915), which the court cited.

\textsuperscript{77} 271 App. Div. 1023, 69 N.Y.S.2d 186 (2d Dep't 1947) (memorandum decision).

individual defendants procured the necessary financing and formed a corporation to which plaintiff's assignor assigned the contract, title to the real property to be taken in the name of the corporation. Almost immediately the property was resold at a profit of $14,000. After paying expenses and repaying investors, $2,500 was set aside for plaintiff's assignor and a similar sum for each of the two individual defendants. No stock was ever issued. Plaintiff brought the action to require the individual defendants to return to the corporate defendant the cash proceeds of the sale and also to require the corporation to issue to him the stock which should have been issued to his assignor and to dissolve the corporation according to law.

The trial court found that a joint venture existed between plaintiff's assignor and the two individual defendants, entitling him to twenty-five per cent of the net profits of the enterprise, which amounted approximately to the $2,500 set aside for him, and refused to pass upon plaintiff's right to the corporate stock.

On appeal, the lower court was affirmed. Two justices voted to reverse and to grant a new trial, citing the Weisman decision and stating that there was no basis for holding that the joint venture persisted after incorporation. Plaintiff took a further appeal on the theory advanced by the dissenting justices. The court of appeals affirmed without opinion.

Decisions Representing the Majority View

The majority of jurisdictions have held in effect that a partnership or a joint venture relationship may persist notwithstanding that the business enterprise is carried on through the corporate form.

One of the earliest decisions is Beardsley v. Beardsley, where the United States Supreme Court held that the parties were joint owners of a railroad enterprise after the defendant had executed a written instrument which made the plaintiff a one-third shareholder in the railroad corporation. The Court in concluding that the transaction between the parties was not a mere stock transaction, said:

They were jointly interested in the construction contract, and by the completion thereof became practically joint owners of the road. That their relations to the corporation were evidenced by stock certificates, does not preclude the fact that, as between themselves, they were joint owners.

The recent case of DeBoy v. Harris is one of first impression in Maryland and hence has received considerable notation in legal periodicals. The case involved an appeal from a judgment dismissing a

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80. Id. at 270.
82. 44 Calif. L. Rev. 590 (1956); 34 Chi.-Kent L. Rev. 161 (1955); 69 Harv. L. Rev. 565 (1956); 16 Md. L. Rev. 348 (1956); 3 U.C.L.A. L. Rev. 94 (1955).
complaint which alleged in substance that plaintiff and defendants had entered into an oral joint venture agreement to acquire sites for the construction of warehouse facilities to be leased, sold for profit, or otherwise dealt in and to create a corporation as the instrument to carry out the venture; that stock was to be issued in proportion to the interests of the parties in the venture; and that defendants as controlling directors and stockholders of the corporation increased its capital stock with the intent to destroy plaintiff's interest in the joint venture by offering such a large number of shares that plaintiff would not be able to maintain his proportionate interest. The complaint demanded damages for the alleged breach of the joint venture agreement.

After reviewing many of the authorities pro and con, particularly Jackson v. Hooper and the New York decisions, the court held that since the corporation was intended merely as a medium to carry out the purpose of the joint venture agreement, the agreement survived the incorporation. In reversing the judgment below the court directed that the case be transferred to the equity court as one for an accounting in view of the duration, size, and complicated financial nature of the joint venture operation.83

The facts in another recent case, Helms v. Duckworth,84 were somewhat unusual. In upholding the fiduciary duty of a minority stockholder to make disclosure of a secret intent, the court said:

In an intimate business venture such as this, stockholders of a close corporation occupy a position similar to that of joint adventurers and partners. While courts have sometimes declared stockholders "do not bear toward each other that same relation of trust and confidence which prevails in partnerships," this view ignores the practical realities of the organization and functioning of a small "two-man" corporation organized to carry on a small business enterprise in which the stockholders, directors and managers are the same persons. A distinguishing characteristic of such a corporation is the absence of a division between the stockholder-owners and the director-managers, for the former either personally manage and direct the business or so dominate the directors as to render the latter agents. Yet, the fiduciary capacity of directors and dominant or controlling stockholders is unquestioned. . . . We believe that the holders of closely held stock in a corporation

83. Whether the action should be at law for damages or a suit in equity for an accounting is discussed in Comment, Joint Venture or Partnership, 18 Fordham L. Rev. 114, 128-29 (1949).
84. 249 F.2d 482 (D.C. Cir. 1957). X, an older businessman, and Y, younger and experienced in business and law, organized a corporation to which X transferred his business assets for the majority stock. Y received the minority stock in exchange for cash. An agreement between X and Y provided that upon the death of either his stock would be sold to the survivor at its par value ($10 per share), unless during succeeding years a different price was fixed. At the time of X's death his stock had a value of $80 per share but Y alleged that he never intended to agree to a change of the original price. X's administratrix sued to cancel the agreement. The court emphasized the facts that X had agreed not to exercise his control to dissolve the corporation or dispose of its assets and that he had depended upon Y in the formulation of the agreement.
such as shown here bear a fiduciary duty to deal fairly, honestly, and openly with their fellow stockholders and to make disclosure of all essential information.86

A recent decision of the intermediate appellate court of New Jersey seems to indicate a departure from Jackson v. Hooper, although that case is not mentioned in the court’s opinion. The case is Fortugno v. Hudson Manure Co.,87 where plaintiff sought dissolution of a family partnership of which he was a member. Through the use of partnership funds the partnership had acquired several corporations for the purpose of carrying on various aspects of its business. Plaintiff claimed that the corporations were assets of the partnership and that since he was an equal partner a dissolution of the partnership entitled him to an equal share of the corporations. The appellate court held that the corporations were assets of the partnership and that since the result of a mere stock distribution would be to transform plaintiff, a full partner, into a minority stockholder, the corporations should be liquidated to allow an equal cash distribution among the partners. The court said:

A partnership may, of course, be created for the prime purpose of buying and selling shares of stock. In such a situation a partnership goes no further than the stock itself; the partners are not entitled to be considered the equivalent of owners of the corporations in which the stock is held. But the partnership in this case was not engaged in the buying and selling of corporate shares; it conducted a manure business in all of its out-branches. As we shall see, the partnership did not obtain the corporate shares that it did simply as an investment, but acquired them naturally in the course of the evolution and expansion of its prime business. The partnership stock ownership was not for the purpose of participating in corporate affairs in the normal manner, but was resorted to in order simply to make each corporation an instrumentality or department of the integrated family enterprise. In similar situations courts have looked through the form to the reality, as if the corporation agency did not exist, and dealt with them as the justice of the case required [citing cases]. . .87

The decision appears to be in accord with the majority view expressed in numerous other decisions.88

85. Id. at 486-87 (footnote citations of court are omitted).
87. Id. at 501, 144 A.2d at 217. The decisions cited by the court dealt solely with the disregard of the corporate entity. The decision is noted in 4 Vill. L. Rev. 457 (1959) where the following observation is made: “By the instant decision, New Jersey had aligned itself with numerous other states adopting the view that a corporation may operate subject to a prior agreement. . .” Id. at 459. Professor Latty refers to another recent New Jersey decision, Katcher v. Ohman, 26 N.J. Super. 28, 97 A.2d 180 (Ch. 1953), which held that there is no public policy requiring close corporations to stick to the statutory scheme of majority control, which is obligatory. Latty, The Close Corporation and the New North Carolina Business Corporation Act, 34 N.C.L. Rev. 432, 437 (1956).
88. Among the decisions representing the majority view are the following: La Varre v. Hall, 42 F.2d 65 (5th Cir. 1930); Wabash Ry. v. American Refrigerator Transit Co., 7 F.2d 335 (8th Cir. 1925), cert. denied, 270 U.S. 643 (1926); Moss v. Waytz, 4 Ill. App. 2d 296, 124 N.E.2d 91 (1955); Mendelsohn v. Leather Mfg. Corp., 326 Mass. 226,
The draftsmen of the recently enacted New York Business Corporation Law were early alerted to the problems peculiar to the close corporation, including specifically the problem here considered. The new statute not only continues, substantially, the provisions of Section 9 of the Stock Corporation Law, and permits pooling arrangements among stockholders and election of officers by stockholders, but, also, in a most significant innovation, permits a provision in the certificate of incorporation which may have the effect of placing management of the close corporation in the hands of the shareholders in place of the directors. Furthermore, under the new statute, a court may decree dissolution where the certificate of incorporation permits any shareholder or a specified number of shareholders to enforce dissolution and also where there is such internal dissension that dissolution will be beneficial to the shareholders. In the latter case dissolution is not to be denied merely because the corporate business has been or could be conducted at a profit.

Nevertheless, these much-needed reforms, while they go a long way towards treating the close corporation realistically, do not solve the basic problem we have considered—namely, the refusal, in general, of the New York courts to recognize the rights and obligations inter se of the members of the incorporated partnership or joint venture. Basically the above changes in respect to close corporations effected by the new statute pertain to specific and fairly limited areas in which, by following the prescribed form, the close corporation may be accorded a degree of partnership treatment.

In view of the predominant position of the New York courts, continually reaffirming the out-worn, unrealistic, and legally insupportable
philosophy of Jackson v. Hooper, a more direct approach to the problem is needed. One such step might be the amendment of the Business Corporation Law to add a supplementary provision somewhat like that contained in the recently enacted North Carolina Statutes.\textsuperscript{96} This provision has been characterized as taking the following basic approach: "no arrangement set out in the charter and by-laws agreed to by all the co-owners or set out in a writing signed by all of them is invalid just because it is a partner-like arrangement."\textsuperscript{97} Perhaps the North Carolina statute is too limiting in its application. Might it not be better to provide that no provision of the Business Corporation Law shall be deemed to preclude a court from finding that stockholders have agreed, expressly or by implication, to treat each other as though they were partners or joint adventurers?

**Conclusion**

*First* The basic assumption that stockholders in a close corporation may not \textit{inter sese} treat themselves as though they are partners or joint adventurers is legally unsound.

*Second* The New York Court of Appeals, if the opportunity is presented to it, should repudiate that doctrine.

*Third* If the court of appeals fails to act, the legislature should amend the Business Corporation Law by adding an appropriate provision which would legislate out of existence the unsound postulate.

\textsuperscript{96} N.C. Gen. Stat. §§ 55-1 to 175 (Supp. 1959). Section 55-73(b) provides: "Except in cases where the shares of the corporation are at the time or subsequently become generally traded in the markets maintained by securities dealers or brokers, no written agreement to which all of the shareholders have actually assented, whether embodied in the charter or bylaws or in any side agreement in writing and signed by all the parties thereto, and which relates to any phase of the affairs of the corporation, whether to the management of its business or division of its profits or otherwise, shall be invalid as between the parties thereto, on the ground that it is an attempt by the parties thereto to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners."