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# Corporations: Pension Plans Involving Spoilation of Corporate Assets

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**Corporations—Pension Plans Involving Spoliation of Corporate Assets** — The Board of Directors of the American Woolen Company approved a "retirement income plan" for the salaried employees of the corporation. The plan was to be put into effect January 1, 1948, and fixed the retirement age at sixty five. The amount each employee would receive was to be determined by a percentage formula, which took into account the employee's salary and length of service, both prior and subsequent to the operative date of the plan. A Mr. Pendleton had been president of the corporation for thirty years and, under this plan, would be sixty five years of age in another year and eligible for an annual pension for life of $54,220. The company proposed to pay $4,657,292 into a trust fund to cover the past services of employees. In the face of the fact that the company had borrowed $10,000,000 during the preceding year plaintiff, a minority stockholder, sought an injunction against the corporation and its directors, alleging that such a pension was "excessive" and "unconscionable," and questioning the proper motives of the directors. The District Court entered summary judgment for the defendant on motion and affidavits. *Held:* reversed. Whether the plan amounted to a spoliation or waste of corporate property or was made in the proper exercise of director judgment was a question for trial. *Fogelson v. American Woolen Co., 170 F. (2d) 660 (C.C.A. 2d 1949).*

This case marks another milestone in a controversial field of corporate law. In the last quarter century large American corporations have been increasingly cognizant of wider responsibilities than were involved in the traditional single concern for maximum profits for shareholders. Forty years ago it was uncommon for corporate management to make any sizeable contribution to charitable and similar organizations. To-day such gifts are more the rule than the exception, and the practice bears close relation to tax considerations. The courts, perhaps mindful of corporate social responsibility, have followed the trend and allowed management wider latitude.[1] The courts tend to sustain a corporate decision, and are reluctant to interfere in the ordinary case. In general management has been reasonable in these matters, and has

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cess. There statutory regulations exist, but such regulations are enacted for the benefit and protection of those financially interested in the corporation and not for the protection of the state."

"The passing interest of the state in their continuance is well illustrated by the fact that a dissolution of the corporation automatically follows upon its failure to file certain reports in the office of the secretary of state. If the corporation were an institution in which the state had a special interest, its life would not be so summarily snuffed out for its mere failure to report the names and addresses of its officers to a public official."

[1] McQuillen v. Nat. Cash Register Co., 112 F.(2d) 887 (C.C.A. 4th 1940), *cert. denied,* 311 U.S. 695 (1940). Cited in 170 F.(2d) 660, 662:

"Courts are properly reluctant to interfere with business judgment of corporate directors; they do so only if there has been a clear abuse of discretion as to amount to legal waste."

not been shackled by many harsh cases which would have arrested such a line of development at its inception. But the question always remains: when will judicial scrutiny of a decision by directors or majority stockholders lead to a judgment for damages, or an injunction?

Obviously a primary purpose of corporate organization is to provide the highest possible dollar return to the investor.[2] But once a business organization becomes a "going concern," it takes its place in the nation, in a community, alongside other human organizations; and it is in this latter aspect that it develops a wider, social significance. It is now settled that management may aid charitable organizations,[3] and provide an infinite number of services for its employees and outsiders. In the long run these plans may or may not yield a profit, and in few cases will the pecuniary advantage be immediate. All this means an immediate sacrifice in dollars and cents to the stockholder, and yet the courts sustain such practices.[4] The adjudicated cases have not been numerous enough to provide answers in many situations.[5] While the courts have been reluctant to interfere, they have done so in a number of cases, most of which hold that such proposals raise questions of fact for trial.

Probably the leading case is *Rogers v. Hill.*[6] In deciding an action by minority stockholders to enjoin a bonus program for certain executives the Court said:

> "We have long since passed the stage in which stockholders, who merely invest capital and leave it wholly to management to make it fruitful, can make absolutely exclusive claim to all profits against those whose labor, skill, ability, judgment, and effort have made profits available. The reward, however, must have reasonable relation to the value of the services for which it is given and must not be, in whole or in part, a misuse or waste of corporate funds, or a gift to a favored few, or a scheme to distribute profits under a mere guise of compensation, but in fact having no relation to services rendered."[7]

[2] Dodge v. Ford Motor Co., 204 Mich. 459, 507, 170 N.W. 668 (1919).
The author points up this problem at p .1162,
"A business corporation is organized and carried on primarily for the profit of the stockholders," and directors cannot lawfully "conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefitting others."

[3] State ex rel Sorenson v. Chicago B. & Q. R. R., 112 Neb. 248, 119 N.W. 534 (1924).

[4] *For whom are corporate managers trustees?*, 45 HARV. L. REV. 1145, 1162 (1932).
"Business—which is the economic organization of society—is private property only in a qualified sense and society may properly demand that it be carried on in such a way as to safeguard the interests of those who deal with it either as employees or consumers even if the proprietary rights of its owners are thereby curtailed."

[5] For the general subject of a bonus for employees, see 40 A.L.R. 1423; 88 A.L.R. 751.

[6] 289 U.S. 582 (1933).

[7] 289 U.S. 582, 590.

This language is frequently quoted by writers on the subject. The Wisconsin Supreme Court used substantially this same standard in *Thauer v. Gaebler,*[8] decided a few yeare before *Rogers v. Hill.* This was a derivative action by minority stockholders to recover a bonus of $500 to an officer for services performed during a preceding year, and to enjoin an increase in salary voted by the board of directors for two of its officers. The Court stated:

> "There must be a clear abuse of discretion, fraud, or bad faith, resulting in spoliation of minority stockholders and ruin to the corporation."[9]

It is implicit in the case that on any strong appeal for relief the court might hold director action to be an abuse of discretion as a matter of *law.* It should be further noted that this whole question is a matter regulated by decisional law. The writer could find no statute applicable to the situation in the instant case.

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**Taxation — Family Partnerships** — Upon the dissolution of the Coon-Culbertson cattle raising partnership taxpayer Culbertson bought up the basic stock with the understanding that his sons be taken into the new business. A new partnership was formed by Culbertson and his four sons. The sons' contributed share of the capital was represented by their note, payment of which was made partly with funds received as a gift from the taxpayer and partly by proceeds of a loan procured from the new partnership. The oldest son rendered some service, although not vital in nature, to the conduct of the partnership before being called to army service. The other sons rendered no service because of either college or army demands for their time, although it was their intention eventually to become active in the business. The taxpayer distributed the profits according to the partnership agreement and included only his distributive share in his federal income tax return. The Tax Court included the entire partnership income in the father's return, holding that the sons did not contribute "vital services" or "original capital" and insisting that these objective tests must be met to establish the existence of a partnership for tax purposes.[1] The Circuit Court of Appeals reversed on a finding of intention to form a partnership and to render future service to it.[2] *Held:* reversed. Both courts handed down decisions based on falacious interpretation of established precedent. The case was remanded to the Tax Court for re-

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[8] 202 Wis. 296, 232, N.W. 561 (1930); noted in 1939 WIS. L. REV. 221; 164 A.L.R. 1133; 175 A.L.R. 594.
[9] 202 Wis. 296, 302, 232 N.W. 561, 564 (1930).
[1] ¶ 47,168 P-H MEMO T.C. (1947).
[2] 168 F(2d) 980 (1948).