
William E. Nelson

Follow this and additional works at: https://scholar.smu.edu/smulr

Recommended Citation
https://scholar.smu.edu/smulr/vol53/iss1/13

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
THE LAW OF FIDUCIARY DUTY IN NEW YORK, 1920-1980

William E. Nelson*

As the center of American, if not world capitalism, New York has specialized in the management and investment of money throughout the twentieth century. Two forms of legal institution—the corporation and the trust—are among the principal devices historically used by New York's money managers in pursuit of their trade. This article will focus on one particular body of doctrine in connection these two institutions—the law of fiduciary duty—specifically, on the level of honesty and care which a manager of money, whether a trustee of a fund or a director or officer of a corporation, owes to its owner.

No explicit changes in doctrine occurred over the course of the century in the black-letter law of fiduciary duty. But the ways in which doctrine was applied did change subtly in two respects. The article will analyze the two changes.

First, the article will discuss a shift in emphasis from protecting investors in the third and fourth decades of the twentieth century to empowering entrepreneurs during later decades. During the earlier part of the century, the courts declared that fiduciaries were bound to the highest of standards of loyalty to their cestuis and were free to make only limited sorts of investments involving no conflicts of interest. Fiduciaries who breached the rules tended to be held strictly accountable. In the latter part of the century, in contrast, judges gave money managers increased freedom to use and invest funds as they saw fit, subject only to the requirement that they use due care in making investment choices. This shift

* Joel and Anne Ekrenkranz Professor of Law, New York University. A.B., Hamilton College, 1962; L.L.B., New York University, 1965. Ph.D., Harvard University, 1971. The Author delivered the lecture for the Roy R. Ray Lecture Series at Southern Methodist University School of Law on April 12, 1999. Helpful comments and criticisms were offered by Greg Mark and by the members of the Legal History Colloquium at New York University, and the Author is deeply grateful and indebted for this valuable assistance. Research support was provided by the Filomen D’Agostino and Max E. Greenberg Faculty Research Fund of New York University School of Law.

1. The rules establishing the basic structure of corporation and trust law were fully elaborated during the course of the nineteenth century. The nineteenth-century history of corporation law in New York is discussed in Ronald E. Seavoy, The Origins of the American Business Corporation, 1784-1855: Broadening the Concept of Public Service during Industrialization (1982), and is also referenced in John W. Cadman, The Corporation in New Jersey: Business and Politics, 1791-1875 (1949). Since the basic rules of corporation and trust law underwent no significant change in the twentieth century, those rules will not be addressed in the pages that follow.
in emphasis toward increased investment freedom occurred, it is sug-
gested, in order to facilitate the upward mobility of people with en-
trepreneurial skills and to further growth of the economy as a whole. The
shift thereby contributed to the complex process occurring in the mid-
twentieth century, which I have discussed elsewhere,2 by which the Cath-
olic and Jewish descendants of turn-of-the-century immigrants from
Southern and Eastern Europe entered the mainstream of American life.

Second, the article will outline a shift in the uses to which attorneys and
litigants put the law of fiduciary duty. During the earlier decades of the
century, courts applied the rules regulating fiduciaries in cases involving
private investment of private moneys in private enterprises. Of course,
the law of fiduciary duty remained applicable to similar private cases
throughout the second half of the century. But, beginning with World
War II, cases involving the law of fiduciary duty arose in international
and other public law contexts as well. Gradually, over the course of the
ensuing decades, the use of fiduciary concepts in cases involving public
policy issues continued to grow, and fiduciary law became a tool courts
used to address public policy matters as well as issues of private invest-
ment management. As we shall see, however, judges refused to use fidu-
 ciary law to address policy issues when doing so threatened to restrict
entrepreneurial freedom.

In portraying these two shifts mentioned above, this article is divided
into three parts. Part I outlines the main doctrines of fiduciary law as it
was applied in trust and corporate cases throughout the century, with
particular stress on the high standards of honesty and care to which fiducia-
ries typically were held during the earlier decades of the century. Part II
then turns to the shifting emphasis appearing in cases from the second
half of the century, encompassing increased support for entrepreneurial
activities promoting general economic growth and upward social mobil-
ity. Finally, Part III considers the growing use of fiduciary law to address
public policy issues, along with the limits that courts placed on that
growth.

I. PROTECTING INVESTMENTS: THE DUTY OF LOYALTY OF
FIDUCIARIES, 1920-1940

The basic fiduciary standard, as stated by the Court of Appeals, has
always been that a trustee is “bound, in the management of all the mat-
ters of the trust, to act in good faith and employ such vigilance, sagacity,
diligence, and prudence as in general prudent men of discretion and intel-
ligence in like matters employ in their own affairs.”3 The “rules of fidel-

son, Contract Litigation and the Elite Bar in New York City, 1960-1980, 39 EMORY L.J. 413,
Will, 177 N.E. 397, 398 (1931); In re Knowler’s Estate, 200 N.Y.S. 777, 778 (Sur. Ct. 1923).
FIDUCIARY DUTY IN NEW YORK

ity expected of one acting in a fiduciary capacity,” according to another court, were “something higher than ‘the morals of the market place.’”

Similarly, the law imposed on officers and directors of corporations and on employees and other sorts of agents a duty “analogous to [that] of a trustee towards his cestui que trust,” even though they did not “technically fall . . . within any of the defined fiduciary categories.”

With “this concept,” according to the leading text of the 1930’s, “corporation law became in substance a branch of the law of trusts,” although the application of fiduciary principles in the corporate context was “less rigorous, since the business situation demanded greater flexibility than the trust situation.”

But the basic fiduciary principle was the same for the corporation as for the trust—that “powers [were] conceded to the management . . . to act for the corporation as a whole[,] . . . not . . . for the purpose of benefiting one set of participants as against another.”

According to this basic concept of fiduciary duty, employees and other agents were “bound at all times to exercise the utmost good faith toward their principals,” to “act in accordance with the highest and truest principles of morality,” and never to “deal for [their] own profit with the moneys of” their principal or to “take or assume a position antagonistic to [their] employer’s interest or duties.”

4. In re Young’s Estate, 293 N.Y.S. 97, 103 (App. Div. 1937). “A principle firmly fixed in equity,” the court added, “was that a trustee may not deal with himself” and that self-dealing “is enough to indicate disloyalty to the estate.” Id. at 102. Accord, e.g., In re Fulton’s Will, 2 N.Y.2d 917, 920 (App. Div. 1938); In re Flint’s Will, 266 N.Y.S. 392 (Sur. Ct. 1933).


7. Id. at 274. Going back to a debate between Adolf A. Berle, Jr., For Whom Corporate Managers Are Trustees, 45 HARV. L. REV. 1365 (1932), and E. Merrick Dodd, For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145 (1932), scholars have disagreed about the precise extent to which corporate fiduciary doctrine does and should mirror trust doctrine. The two leading recent articles are Norwood P. Beveridge, Jr., The Corporate Director’s Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction, 41 DEPAUL L. REV. 655 (1992); Harold Marsh, Jr., Are Directors Trustees? Conflict of Interest and Corporate Morality, 22 BUS. LAW. 35 (1966). This Article takes no position in regard to this disagreement; it recognizes that the scope of fiduciary duty in corporate and trust law were never identical in this century and argues only that both bodies of law changed in the same direction, though not necessarily at the same rate, as the century progressed.


tors of a corporation owe[d] to it their undivided and unqualified loyalty" and could "never be permitted to profit personally at the expense of the corporation" or to "allow their private interests to conflict with the corporate interests." In addition to liability for conflicts of interest, fiduciaries were also liable for negligent breach of the duty of care which resulted in damage—that is, for failure to use the ordinary skill and judgment of a reasonable person. As Chief Judge Cardozo eloquently summed up the law of the 1920's in Meinhard v. Salmon, fiduciaries were 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.

Although Meinhard was a partnership rather than a corporate or trust case, it was also cited in the corporate and trust contexts. Nevertheless, its impact on corporate fiduciary law is unclear, since states like Delaware and New Jersey had already begun a process of inducing corporations to incorporate in their jurisdictions by providing them with favorable law. Important legislative changes limiting the ability of judges to protect non-controlling shareholders from management self-favoritism were enacted in Delaware in 1927 and 1929, thereby making Meinhard's impact uncertain at best.

Whatever its actual applicability in the day-to-day administration of corporate law, however, Meinhard reflected a prevalent ethos in Cardozo's time with regard to corporate as well as trust issues—an ethos that was evidenced not only in the case law but also in the passage in 1933 and

---


15. Meinhard, 164 N.E. at 546.

16. See supra note 1.

17. This "race to the bottom" has been the subject of immense scholarly literature. See, e.g., Roberta Romano, The Genius of American Corporate Law (1993).

1934 of the two statutes which even today constitute the centerpiece of corporate law, the Securities Act of 1933 and the Securities Exchange Act of 1934, both of which were designed to protect investors from money managers who manipulated markets for their own profit at investors’ expense. One need only remember the rhetoric of Franklin Roosevelt, who in campaigning for the reform of Wall Street and in signing the 1933 act, condemned the “practices of the unscrupulous money changers,” who “had shown themselves either incompetent or dishonest in their handling of the people’s funds[,] . . . had used the money entrusted to them in speculations and unwise loans,” and, as a result, stood “indicted in the court of public opinion.” The new legislation, the President promised, would rectify the failings of existing state fiduciary law and thereby “correct some of the evils which ha[d] been so glaringly revealed in the private exploitation of the public’s money.”

Based on the principle of loyalty elaborated in Meinhard and in the 1933 and 1934 acts, courts during the 1920’s and 1930’s, as well as later decades, routinely held numerous fiduciaries liable for breach of duty. Among fiduciaries held liable for breach of duty were managers or directors who used their position to seize control of corporations or assist others in doing so, to obtain unfair bargaining power over principals, to engage in secret or excessively profitable purchase or sale transactions with respect to those to whom they owed a duty, or to divert business and profits away from individuals or corporations to which the business or profits rightfully belonged. A court could validate an otherwise invalid transaction, however, if upon full factual examination, it found it to be fairly and openly made upon adequate consideration.

21. See Seligman, supra note 18, at 6-100. Seligman’s tome develops fully the history of the statutes and of the case law elaborating them, which is beyond the scope of the present article.
22. Id. at 29-30.
23. Id.
In addition to liability for breach of the duty of loyalty, fiduciaries were held liable for waste or other loss of trust or corporate assets resulting from negligence. Numerous cases held that a trustee who placed trust funds in an investment not on the list of statutorily approved investments was liable for any losses unless the settlor had specifically authorized the investment. However, failure to diversify investments, without more, did not constitute waste.

173 (App. Div. 1934); see also Mills v. Bluestein, 9 N.E.2d 944 (N.Y. 1937) (refusing to hold trustee liable for loss of investment if all possible care had been used in connection therewith); cf. In re Ungrich, 190 N.Y.S. 187 (Sup. Ct. 1921) (permitting beneficiary to approve and thereby validate unlawful investment of fiduciary).


32. See In re Young's Estate, 288 N.Y.S. 569 (Sup. Ct. 1936). There were some issues, though, over which courts in the 1920's and 1930's were divided. One was whether an inactive trustee or director who left management of trust or corporate affairs to fellow trustees or directors was liable for their misfeasance. Compare Jersawit v. Kaltenbach, 1 N.Y.S.2d 756 (App. Div. 1938) (treasurer and director not responsible for wrongful act of corporation president); Hill v. International Prods. Co., 220 N.Y.S. 711, 744 (Sup. Ct. 1925) (director not responsible for wrongful act for which he did not vote); In re Whitmore's Estate, 15 N.Y.S.2d 379 (Sup. Ct. 1939) (sister trustee who allowed her two brother trustees to administer trust not liable for their misfeasance); In re Dawes' Estate, 12 N.Y.S.2d 6 (Sup. Ct. 1939) (trustee not active in administration of trust and who received no money or property not liable for misfeasance of co-trustee), with Brown v. Phelan, 228 N.Y.S. 466 (App. Div. 1928) (co-trustees who signed inventory but left fellow trustee in total control liable for misfeasance); In re Binder, 15 N.Y.S.2d 4, 6 (Sup. Ct. 1939) (director has "burden of active, diligent, and single-eyed service") (quoting People v. Marcus, 185 N.E. 97, 98 (N.Y. 1933); VanSchaick v. Aron, 10 N.Y.S.2d 550, 562 (Sup. Ct. 1938) (director liable for misfeasance of co-director if director was negligent In respect thereto); Walker v. Man, 253 N.Y.S. 458, 462 (Sup. Ct. 1931) ("director may not shut off liability by shutting off his hearing and sight"). Another unsettled issue was the power of a settlor of a trust to authorize a trustee to engage in otherwise prohibited acts. See In re Balse's Will, 274 N.Y.S. 284 (Sur. Ct. 1934) (testator's approval of trustee's investments provides authorization therefor), modified on other grounds, 280 N.Y.S. 128 (App. Div. 1935). Cf. In re Doelger's Estate, 299 N.Y.S. 565 (Sur. Ct. 1937), rev'd on other grounds, 4 N.Y.S.2d 334 (App. Div. 1938) (testator may require trustees to organize corporation to continue his business). Another concerned the capacity of beneficiaries to ratify and thereby legitimate prohibited acts of fiduciaries. Compare In re Schoeneweg's Estate, 14 N.Y.2d 777 (N.Y.1938) (written release by remainderman bars claim against trustee); Holland v. Presley, 8 N.Y.S.2d 804 (App. Div. 1939) (upholding settlement by corporate directors of misfeasance of president); Alexander v. Kotzen, 19 N.Y.S.2d 400 (Sup. Ct. 1940) (acquiescence in investment bars subsequent objection by beneficiaries); In re Packard's Estate, 261 N.Y.S. 580 (Sup. Ct. 1932) (acquiescence in investment bars subsequent objection by remainderman), with Skinnell v. Mahoney, 189 N.Y.S. 845 (App. Div. 1921) (consent of contingent remaindermen required to validate wrongful acts of trustees). Another was about the formalities and procedures required for an act of fiduciaries to bind a corporation or trust. Compare Knapp v. Rochester Dog Protective Ass'n, 257 N.Y.S. 356 (App. Div. 1932) (only formal meeting with minutes can bind corporation); Allison & VerValen Co. v. Mcnee, 9 N.Y.S.2d 708, 713 (Sup. Ct. 1939) (unanimous consent of trustees required to bind trust), with Kahn
An especially difficult issue confronting judges concerned how to balance the conflicting obligations of fiduciaries to use good faith, diligence, and prudence in dealing with multiple beneficiaries. It was settled, for example, that corporate officers and directors were responsible not only to stockholders, but also to a corporation’s creditors, and the interests of these two groups sometimes were in conflict.\textsuperscript{33} Similarly, most trustees were responsible both to current beneficiaries of a trust and to holders of future interests\textsuperscript{34} as well as to the mission and memory of the settlor.\textsuperscript{35} This latter conflict led to the development of complex law on the issue, for instance, of whether money paid to a trustee should be treated as income payable to present beneficiaries or principal to be preserved for future ones.\textsuperscript{36} Similar complex doctrine developed on the question of whether certain expenses should be charged to a trust’s income or principal account.\textsuperscript{37}

High-toned rhetoric of the sort used by Cardozo in \textit{Meinhard v. Salmon}\textsuperscript{38} was typically used by judges in their analysis of fiduciary duty, especially during the 1920’s and 1930’s, and the cases create the impression that the rhetoric to some degree affected results.\textsuperscript{39} At the same time, however, judges recognized that the status of fiduciary had business qualities. Prior to 1940, the business aspects of fiduciary law were reflected mainly in the rules allowing fiduciaries to receive financial compensation for their services, although only in amounts regulated by statute.\textsuperscript{40} But

\begin{footnotesize}

34. See April v. April, 7 N.E.2d 711 (N.Y.1937); In re Osborn, 299 N.Y.S. 593 (App. Div. 1937); In re Phelps’s Estate, 295 N.Y.S. 840 (Sur. Ct. 1937).

35. See President and Directors of Manhattan Co. v. Prudence Co., 194 N.E. 408 (N.Y.1935) (trustee bound by provisions of trust agreement).

36. See In re McManus’ Will, 26 N.E.2d 960 (N.Y.1940); City Bank Farmers Trust Co. v. Wylie, 7 N.E.2d 241 (N.Y.1937); In re Martin’s Will, 199 N.E. 491 (N.Y.1936).

37. See In re Rowland’s Estate, 6 N.E.2d 393 (N.Y. 1937); In re Jackson’s Will, 179 N.E. 496 (N.Y.1932); Furniss v. Cruikshank, 132 N.E. 884 (N.Y. 1921); In re Martin’s Estate, 1 N.Y.S.2d 80 (Sur. Ct. 1937).

38. 164 N.E. 545 (1928).

39. See supra notes 1-2 and accompanying text.

after 1940, a business-centered approach to the law of fiduciary duty gained increasing importance in other respects.

II. FIDUCIARIES AS UPWARDLY MOBILE ENTREPRENEURS, 1940-1980

In the 1940's and the decades that followed, subtle changes began to occur in the application of the law of fiduciary duty. Although courts did not alter the formal rules of black-letter doctrine in any drastic fashion,\textsuperscript{41} they did begin, during the course of the 1940's and thereafter, to apply them in a more pragmatic fashion that was increasingly sensitive to the entrepreneurial needs of both fiduciaries and beneficiaries. In particular, the courts grew more tolerant of higher-risk investment practices of entrepreneurial fiduciaries who sought to increase income or grow principal and less concerned with ensuring the security of investments.

\textit{Washer v. Seager}, with its stated refusal to "exalt form over substance,"\textsuperscript{42} set the tone of pragmatism and preference for entrepreneurship to which most judges adhered in subsequent years. For approximately two years, Washer and Seager had been the two sole shareholders and the officers and directors of a clothing manufacturing


41. \textit{See supra} notes 2-29 and accompanying text.

company. "Seager had furnished the business skill and ability; Washer was financier."\(^4\) \(^2\) When Seager decided in 1943 to break with Washer and enter the same business with another firm, Washer brought suit for breach of the duty of loyalty. However, the court, reasoning that Washer was "attempting to... establish a right to share indefinitely, as an inactive partner, in Seager's business ability, skill and enterprise,"\(^4\) \(^3\) ruled that Seager was free to leave one firm and use his entrepreneurial skills to enter into competition with it on behalf of a new firm. In so ruling, the court expressed its emerging preference for encouraging entrepreneurs to use their skills to promote their own upward mobility as well as the economy's growth, even at the expense of rentier capitalists seeking investment security.

Other cases agreed that an employee had "the right to leave" his employment, "establish his own business, solicit" his former employer's "customers and compete... in free enterprise, unless he were either contractually restricted from doing so or some fraud or unfair competition were involved."\(^4\) \(^5\) A director or employee also was free, at least in the absence of a specific agreement to the contrary, to work for another employer,\(^4\) \(^6\) even in dealing in competing products.\(^4\) \(^7\) As the court in Feiger v. Iral Jewelry, Ltd.\(^4\) \(^8\) stated when an employer tried to interpose a defense of breach of fiduciary duty against an employee who sued to recover unpaid commissions earned before he deserted the employer in order to open his own business:

plaintiff was simply pursuing the normal American dream of bettering himself by going out on his own, and he did it without harming defendant in any way. To deprive him of his hard-earned commissions—when preparing for his new enterprise involved neither taking secrets or special knowledge away from defendant, nor lessening his work for defendant while he remained there—would be to unjustly enrich defendant. Much as I sympathize with defendant's unhappiness over being deserted by his partner, together with his sole and valued salesman, the Court cannot be a party to solacing that unhappiness with plaintiff's earnings.\(^4\) \(^9\)

Another doctrine, which courts in the 1940's began to subtly transform, dealt with the appropriation by majority directors of business opportunities belonging to their corporation. The turning point was Blaustein v.

\(^{43}\) Id.
\(^{44}\) Id.
\(^{49}\) Id. at 220.
Pan American Petroleum & Oil Transport Co., where Supreme Court Justice Samuel I. Rosenman presided over a 70-day nonjury trial. At issue was whether Standard Oil of Indiana, which owned nearly 80% of Pan American's shares, aided and abetted by Standard Oil of New Jersey, had deprived Pan American's wholly owned subsidiary, the American Oil Co., the creator of premium-grade gasoline under the brand name Amoco, of profitable opportunities to drill and refine oil on the Texas Gulf coast. Applying the traditional principles found in Meinhard v. Salmon and the 1933 and 1934 securities acts that “equity . . . demands of a trustee undeviating loyalty to his beneficiary” and that a “fiduciary is forbidden to enter a situation where personal interest will conflict with the interest of his principal,” Rosenman held that the directors of Pan American had diverted its business opportunities to Standard of Indiana, from which they, in turn, received benefit, and thereby breached their fiduciary duty.

The Appellate Division reversed. It found that Pan American's directors had acted “in good faith and in the exercise of their honest judgment,” on the advice of counsel and without profit to themselves, and thus had not breached their duty as fiduciaries. The Court of Appeals agreed. Although Judge Irving Lehman in dissent concluded that Pan American's directors, all of whom were officers or directors of Standard or its other subsidiaries, acted at the direction of and on behalf of Standard and therefore were in breach of their duty to Pan American when they diverted its business opportunities to Standard, the majority shared the Appellate Division's view that “[q]uestions of policy of management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests, are left solely to the . . . honest and unselfish decision” of directors who, provided they act “in good faith and the exercise of an honest judgment” without personal gain to themselves, fulfill their fiduciary duty.

Two months after the Court of Appeals decision in Blaustein, the Appellate Division decided Turner v. American Metal Co. Like Blaustein,
Turner was a case in which several individuals held officerships or directorships on both a parent and its subsidiary corporation and thus faced conflicts of interest. The Appellate Division declared, however, that "the mere existence of such a divided loyalty did not, of itself, warrant the imposition of liability against directors."60 In view of the parent's large financial stake in the subsidiary, the Appellate Division stated that the parent's officers and directors "not only had the right but were under a duty to act as directors [of the subsidiary], rendering such services as were necessary."61 The Court continued that they "committed no wrong in entering into reciprocal arrangements for the supplying of information and technical data and for the exchange of routine services beneficial to both companies."62 It concluded that the "law [was] well settled that minority stockholders may not interfere with the management of a corporation so long as the trustees are acting honestly and within their discretionary powers."63

It is noteworthy in the Blaustein case that two judges closely associated with the New Deal—Samuel Rosenman, who had been counsel to Franklin Roosevelt during his governorship, and Irving Lehman, the brother of New Deal Governor Herbert Lehman—both stood by traditional notions of fiduciary duty with their emphasis on high ethical standards, avoidance of conflict of interest, and security of investments. In the final Blaustein and Turner decisions, on the other hand, most of the New York judiciary leaned in the direction of enhancing the entrepreneurial freedom of business managers at the possible expense of fully equitable treatment of investors inactive in corporate governance. These decisions had a striking parallelism to cases like Washer and Feiger.

Another doctrine that tended to enhance entrepreneurial freedom at the expense of investor equity was the business judgment rule, which was fully elaborated in the 1940's. The business judgment rule was not entirely new in that decade, however. Courts had long announced that directors were "clothed with the power of controlling the property [of a corporation] and with its management" and that "the soundness or wisdom of the directors' judgment [would] not be judicially reviewed, where there is neither bad faith nor fraud."64 There were even old references to the words "sound business judgment."65 But key developments did begin to occur in the early 1940's.

The first case of significance in that decade was Nilan v. Colleran,66 in which the Court of Appeals held that an international union properly

60. Id. at 830.
61. Id. at 829.
62. Id.
66. 27 N.E.2d 511 (1940).
chartered a new local union in rivalry with an existing local on behalf of which plaintiff brought suit. The Court reasoned unanimously that the decision to grant a new charter “was within the discretion and business judgment” of the international board, even though it “may have been discriminatory” in regard to the existing local. 67 Although Nilan was not a corporate case, the Court in its decision deployed the language of business judgment in a fashion precisely analogous to that in which future corporate cases would use it.

Even more important was In re Miglietta, 68 where a divided Court of Appeals addressed the issue of whether a board of directors of a mortgage salvage corporation could sell the corporation’s only asset—realty obtained pursuant to a foreclosure—without shareholder approval. Three judges, including Chief Judge Irving Lehman, who, as mentioned earlier, dissented in Blaustein v. Pan American 69 out of concerns for equity to minority shareholders, voted in favor of requiring shareholder approval as the only means by which minority shareholders could protect their interests. A four-judge majority, however, applied the business judgment rule and held, on the ground that the corporation’s divestiture of the asset “manifestly was a sale in the regular course of its business,” 70 that the sale required nothing other than the good faith approval of the board. Again, the managerial freedom of entrepreneurs had triumphed at the expense of protecting minority shareholders.

Meanwhile, lower courts were reifying doctrine. Thus, the First Department wrote in 1941 that as long as “a director exercises his business judgment in good faith on the information before him, he may not be called to account through the judicial process” and that a minority shareholder seeking to call directors to account had “to allege facts showing more than error in business judgment.” 71 Three years later, a trial judge wrote that “there [could] be no quarrel” with “the business judgment rule, so-called, and . . . [the] numerous authorities standing for the proposition that a court [would] not substitute its judgment for that of duly constituted officers and directors.” 72 By the time a trial judge refused to enjoin the departure of baseball’s New York Giants to San Francisco on the ground that no one could “question the efficacy of a business judgment of the Board of Directors,” 73 the business judgment rule had become an accepted part of New York jurisprudence 74 and a Court of

67. Id. at 514-15.
68. 39 N.E.2d 224 (N.Y. 1942).
70. 39 N.E.2d at 228.
Appeals case, *Kalmanash v. Smith*, 75 had been identified as its source, 76 even though that case referred only to the concept of the rule and not to any specific language. Thereafter, the business judgment rule was cited with frequency 77 and it even made appearances in trusts and estates, as distinguished from corporations cases. 78

It is still difficult to be certain about the significance of this reification of the business judgment rule. Judges were applying the substance of the rule throughout the early decades of the century in cases involving breach of the duty of due care, and the main change that occurred in the 1940’s was that they assigned a label to what they were doing. But labels can matter. As *Matter of Miglietta* illustrates, the reification of the business judgment rule probably gave judges a better basis than they previously possessed for declining to enforce the duty of loyalty, with its focus ultimately on issues of equity between shareholders, and instead, deciding cases “on the practical basis” 79 that entrepreneurs should be left free to manage corporations efficiently—an approach leading to enforcement only of the duty of care.

Other cases likewise favored entrepreneurial efficiency and its attendant upward mobility over investor protection. As Jack Weinstein, an eminent federal judge, declared in the 1960’s: “[m]any managers of large enterprises . . . [were] men of relatively limited financial resources who [had] risen quickly and recently through the technical ranks because of their skill and optimism.” 80 Weinstein added that “rule[s] of law too restrictive and inflexible may overinhibit and dampen their drive without providing gain to the investor.” 81 Other judges similarly fostered the upward mobility of new, often Catholic and Jewish entrepreneurs when they reached a variety of holdings—that a corporate officer or director, if acting in good faith, may profit from dealings with the corporation if the corporation also profits; 82 that the directors of a corporation in the process of acquiring another corporation need not disclose all their plans for

75. 51 N.E.2d 681, 687 (N.Y. 1943).


81. *Id*.

using the acquired corporation to enhance the acquirer's profits;\textsuperscript{83} and that an investment company need not account to a corporation for profits made as a result of information acquired during its negotiations to buy the corporation's debentures.\textsuperscript{84}

In pursuit of analogous policies, still other judges held that honest reliance on advice of counsel protected directors from personal liability;\textsuperscript{85} that "policies of expansion" justified nonpayment of dividends;\textsuperscript{86} that a board of directors could remove a dissenting and uncooperative president in the interest of corporate unity;\textsuperscript{87} and that, in the absence of loss of corporate funds or of personal profit to itself, management could authorize a corporation to purchase its own stock in the open market in order to perpetuate management's control.\textsuperscript{88} The courts also bent traditional rules of fiduciary duty to facilitate the accumulation of start-up capital for new enterprises\textsuperscript{89} and to create new institutional arrangements, such as agents for actors,\textsuperscript{90} needed for particular industries to function.

The judiciary's concern for practicality, efficiency, and entrepreneurship also manifested itself in the law of trusts. Therefore, when Congress, in 1969, altered the terms on which trusts could accumulate and distribute money to charities, the New York courts promptly amended the terms of trusts created under the old Internal Revenue Code so they could continue to operate with all available federal tax benefits under the new law.\textsuperscript{91} Similarly, when changes in conditions relating to real estate financing made it impossible to comply with a trust settlor's investment restrictions, the trustees were "freed from the obligation imposed by" the trust and directed "to invest the funds of the trust estate in any of the investments authorized under . . . existing law."\textsuperscript{92} Other cases held that trustees could cooperate with family members to maintain family control of close corporations\textsuperscript{93} and that fiduciaries could rely on electronic methods

\textsuperscript{84}. See Frigitemp Corp. v. Financial Dynanics Fund, Inc., 524 F.2d 275 (2d Cir. 1975).
\textsuperscript{89}. See Semensohn v. Weisblum, 118 N.Y.S.2d 57 (Sup. Ct. 1952).
\textsuperscript{90}. See Mandel v. Liebman, 100 N.E.2d 149 (N.Y. 1951).
\textsuperscript{93}. See Semensohn v. Weisblum, 118 N.Y.S.2d 57 (Sup. Ct. 1952).
\textsuperscript{94}. See Mandel v. Liebman, 100 N.E.2d 149 (N.Y. 1951).
\textsuperscript{96}. See In re Cowles' Will, 235 N.Y.S.2d 160, 171-72 (App. Div. 1965); In re Hirshon's Will, 221 N.Y.S.2d 583 (Sur. Ct. 1961). However, trustees who controlled a corporation through means of their own stock combined with trust stock were required to disclose details of the corporation's activities. See In re Voice's Will, 227 N.Y.S.2d 991, 994 (Sur. Ct. 1962). For other cases dealing with the relationship between trust and corporate fiduciary
of verification of security ownership when they were "unable to verify the securities because of the necessities of modern technology in the transfer of such securities." The courts also upheld investments in common trust funds against objections in order "to provide small investors with the safety of diversified investment through a single medium." Finally, judges in the 1970's, partly in response to legislation, modified ancient strictures against invasion of principal in favor of income beneficiaries, and recognized that "public policy," on occasion, justified the transfer to those beneficiaries of "the principal of spendthrift trusts." The rule changes and shifts in judicial emphasis that this Part has examined made sense in the socio-economic context of the 1940-1980 period.

The most significant element in the context was inflation. By 1980, the dollar had declined to merely 16.98 percent of its 1940 value, with the result that a fixed-value investment of $1000 in 1940, with interest paid out annually, would return a principal in 1980 with a purchasing power of only $170 in 1940 dollars. Inflation made real return of principal possible only if a money manager took added risks in order to make a growth investment, and thus inflation required courts to reconsider the traditional assumption that an investment should at some date in the future return principal intact, with periodic interest payments during the investment.
Once inflation began to take its toll, the legal system simply had to authorize fiduciaries to engage in somewhat more entrepreneurial investment policies than had been customary during the 1920's and 1930's.

Beginning with World War II, federal tax policies also made it impossible for fiduciaries to follow the conservative, non-entrepreneurial investment practices that had earlier been customary. In 1942, the top income-tax rate rose to 88 percent on incomes over $200,000\(^{100}\) and, in 1944, to 94 percent.\(^{101}\) In 1963, after major tax reduction legislation, the top rate still was 70 percent,\(^{102}\) where it remained until the 1980's. Of course, the Internal Revenue Code was filled with countless loopholes designed to induce investors to engage in the kinds of activities favored by the Code. Taken together, inflation, high tax rates, and tax loopholes forced investors to allot their money as the loopholes directed or else watch their wealth dwindle as the value of the dollar declined. Federal law and policy thus overwhelmed traditional state rules requiring conservative investments by fiduciaries and forced money managers to become entrepreneurs.

Nonetheless, entrepreneurial investment policies might not have been adopted if they had not succeeded. But they did succeed, at least in part because the American economy enjoyed unprecedented growth during World War II and the postwar decades. Measured in constant dollars, gross national product rose 186 percent between 1940 and 1950, another 77 percent between 1950 and 1960, and by 1980, was 930 percent greater than in 1940.\(^{103}\) This growth meant that most entrepreneurial investors achieved the results which they sought, and this success, in turn, reduced the pressure for adherence to the traditional, conservative investment rules that might have existed if the economy had been less prosperous and many more fiduciaries had made investments resulting in a loss.

The judiciary’s deemphasis of the old common-law rules protecting investors was further aided by federal legislation that superseded the common law. Both the Securities Act of 1933 and Securities Exchange Act of 1934, as we have seen, reflected the era’s concerns over investor protec-

---

\(^{100}\) See Revenue Act of 1942, ch. 619, §§ 102-03, 56 Stat. 798, 802-03.


\(^{103}\) See Historical Statistics, supra note 99, at 224; Statistical Abstract, supra note 98, at 443. Due to changes in the Government's statistical categories, it was necessary to move from GNP to GDP in making the calculation for 1980. Both GNP and GDP are readily available for 1960, and thus the 930 percent figure in the text reflects percentage increase in GNP to 1960 and percentage increase in GDP after that date. In comparison with these post-1940 growth rates, the growth rate from 1920 to 1929 was a mere 12.7 percent, and with the Great Depression, gross national product fell below its 1920 amount, which it did not again attain until 1940. The 1929 GNP was not reached and surpassed until 1941, by which time the phenomenal growth of the new era had begun. See Historical Statistics, supra note 99, at 224.
tion. The two statutes embraced disclosure mechanisms, administrative regulations, and ultimately civil remedies designed to guard against insider manipulation of capital markers, and thus created safeguards for investors that were superior to those extant under the common law of fiduciary duty.\textsuperscript{104} By 1980, a massive body of investor-protective case law had matured,\textsuperscript{105} and its existence left common-law adjudicators somewhat freer to pursue objectives other than the protection of investors.

The final element which in context may have contributed to the shift to rules authorizing fiduciaries to make more entrepreneurial investments was a conscious policy choice, made by both courts and legislatures, to promote upward socio-economic mobility rather than preserve the existing class structure. The tax and monetary policies considered above surely had such an effect, as did one of the most important pieces of Congressional legislation emerging out of World War II—the GI Bill giving veterans of the war generous educational opportunities and financial support for home purchases.\textsuperscript{106} The New York legislature, in turn, contributed to a program of encouraging the underprivileged to purchase homes through a civil rights law outlawing discrimination on the basis of race, ethnicity, or religion,\textsuperscript{107} and the court of appeals added its imprimatur by protecting Catholic churches and synagogues against discriminatory zoning legislation.\textsuperscript{108} The judiciary's rejection of a traditional policy of requiring fiduciaries to protect established wealth and its substitution of a new policy of encouraging men of relatively limited financial resources to rise through the ranks on the basis of their skill and optimism was the analog in investment management to the zoning, mortgage, and educational policies that brought the immigrant underclasses of the 1920's into the mainstream of New York's economy, society, and culture by the

\textsuperscript{104} The best history of federal securities regulation is Joel Seligman, \textit{The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance} (1995). This history is outside the scope of the present article.


\textsuperscript{107} See id.

III. FIDUCIARY DUTY AND THE PUBLIC INTEREST, 1940-1980

The second change that occurred in New York’s law of fiduciary duty in the decades following 1940 was in the subjects to which the law was applied. Beginning in 1940, chaos in Europe generated cases in which traditional issues of fiduciary duty arose in international contexts rather than in the familiar context of one New Yorker investing money on behalf of another. As the years advanced, cases reflecting the changing posture of the United States in the world order continued to arise. Cases involving domestic public policy issues also began to appear after 1940. By 1980, fiduciary law had become a tool with which courts routinely addressed public policy matters as well as issues of private investment management.

The crises first of World War II and then of the Cold War produced several novel cases involving application of the law of fiduciary duty in international contexts. One case, for example, was brought by Maurice Feuchtwanger, a citizen of France who appears to have fled to New York in 1940.110 In May 1939, before fleeing, he had purchased $81,500 of United States Federal Reserve Notes through an Amsterdam brokerage house and the Bank of Montreal, which on his instructions held the notes “for account of Banque Jordaan, Paris, in favor of Maurice Feuchtwanger.”111 In January 1940, Banque Jordaan, without Feuchtwanger’s knowledge, transferred the notes to Central Hanover Bank in New York, which refused Feuchtwanger’s demand for the money after he had learned in October 1940 of its location. But, in a cryptic opinion without analysis, the Court of Appeals ruled that Central Hanover held the money in trust for Feuchtwanger and directed its payment to him.112

Feuchtwanger appears to have been a victim of Nazi persecution, and the solicitude which the courts showed for his case raises the question whether they aided such victims in general. In fact, they did not. If anything, New York courts were somewhat hostile to the victims of Nazi persecution113 and displayed favoritism toward, if anyone, German nationals and business entities. For example, when a victim of persecution, whose “plight of necessity stir[red] sympathy,”114 brought suit against a New York charity to which postwar West Germany had given money for the rehabilitation of Jewish victims of Nazism, a Supreme Court Justice denied relief on the ground that only the Attorney General could bring suit

111. Id. at 434.
112. Less $16,500 which Feuchtwanger admitted he owed to Banque Jordaan. See id.
113. See Nelson, supra note 108, at 36.
on behalf of beneficiaries of a charitable trust.\textsuperscript{115} Similarly, in a shareholders' derivative suit against the management of F.W. Woolworth for failure to collect profits from its German subsidiary, another justice upheld the validity of a Nazi regulation prohibiting the transfer of those profits out of Germany,\textsuperscript{116} while an upstate surrogate ruled that, after October 1951, Germans were no longer enemy nationals and could therefore succeed to property of a New York decedent.\textsuperscript{117} On the other hand, a complaint in a derivative suit alleging that the directors of Standard Oil of New Jersey had improperly transferred profits into the hands of I.G. Farbenindustrie Aktiengesellschaft, pursuant to a worldwide conspiracy to monopolize the oil and chemical industries, was upheld in part against a motion to dismiss.\textsuperscript{118}

\textit{Kingdom of Sweden v. New York Trust Co.}\textsuperscript{119} also arose out of conditions related to the Second World War. It involved the Kingdom's efforts in January 1942 to purchase nitrogen-grade toluene necessary for the manufacture of explosives, for which New York Trust Co. had issued to the seller a letter of credit in the amount of $176,000 debited to the Kingdom's account. However, before the toluene could be shipped, the United States seized it by eminent domain and gave a compensation award of less than $79,000. Thus, either the seller, the bank, or the Swedish government was out $97,000.

Identifying the victim of the loss depended on which entity had title to the toluene, which depended on whether New York Trust had properly issued the letter of credit, which, in turn, depended on whether New York Trust's relationship to Sweden was that of a fiduciary with duties of disclosure or merely that of an arms-length, independent contractor. The court refused to hold New York Trust to be a fiduciary, since that "would necessarily disturb a common commercial practice, and courts will not lend their aid in achieving a result which would create turmoil in the business and financial world."\textsuperscript{120} Since New York Trust was not a fiduciary, it had no duty to warn Sweden of possible risks involved in purchasing toluene, its letter of credit constituted valid payment for the toluene, and upon receipt of payment by the seller, title to the toluene passed to Sweden.

\textit{Sabbagh Bros., Inc. v. Lufty}\textsuperscript{121} grew out of the Pacific War. Sabbagh, prior to the outbreak of hostilities between Japan and the United States in December 1941, had furnished cash to Lufty, its agent in China for the purchase and fabrication of materials. Lufty had failed to deposit the money in a bank, and, as a result, it apparently was confiscated by Japan when the war began. Did this failure to use a bank constitute a breach of

\begin{itemize}
\item \textsuperscript{115} See id.
\item \textsuperscript{116} See Schwab v. Kirby, 21 N.Y.S.2d 991 (Sup. Ct. 1940).
\item \textsuperscript{117} See In re Von Rumohr's Will, 127 N.Y.S.2d 327 (Sur. Ct. 1954).
\item \textsuperscript{118} See Clayton v. Parish, 73 N.Y.S.2d 727 (Sup. Ct. 1947).
\item \textsuperscript{119} 96 N.Y.S.2d 779 (Sup. Ct. 1949).
\item \textsuperscript{120} Id. at 791.
\item \textsuperscript{121} 112 N.Y.S.2d 209 (Sup. Ct. 1952).
\end{itemize}
the fiduciary duty owed by an agent to its principal? Under the circumstances, the court held that it did not and thus that Sabbagh rather than Lufty should bear the loss unforeseeably arising out of the war.\textsuperscript{122}

No clear doctrinal pattern emerges out of these cases involving Germany, Japan, and World War II. Courts addressed each case independently on its apparent facts. If anything, New York judges favored German nationals and citizens, perhaps to ensure that no one could question their fairness.

In contrast, New York courts ruled more consistently in favor of victims of Communist tyranny. In \textit{Sulyok v. Penzintezei Kozpont Budapest},\textsuperscript{123} the former president of Hungary's Central Corporation of Banking Companies sued the Corporation for breach of his employment contract, made in September 1945, and for pension rights allegedly due from the defendant as plaintiff's fiduciary. He had worked in accordance with the contract, until in June 1947 he made a speech in the Hungarian Parliament attacking the incumbent regime, asserting that it had contributed to the oppressive conditions in Hungary generated by Soviet occupation. Thereafter, on August 9, 1947, a decree was signed by the President of Hungary discharging plaintiff from his office with defendant.\textsuperscript{124} The President told the plaintiff that he would have to bear the consequences of his conduct "because the Russians do not joke in such matters." Three days later another decree was signed appointing someone else as president of the defendant corporation. After midnight of August 15, 1947, plaintiff and his wife escaped across the border into the American zone of Austria, disguised as peasants. In October, 1947, a decree was issued depriving plaintiff of his Hungarian citizenship.\textsuperscript{125} On these facts, the court ruled that plaintiff had been fired in breach of his contract and affirmed an award of damages in excess of $70,000, including pension rights, to be collected out of funds of the defendant that had been attached in New York City.

Nine years later, the New York judiciary remained equally suspicious of Hungarian authorities, when the Manhattan Surrogate upheld the refusal of the trustee of the proceeds of Bela Bartok's estate to remit those proceeds to Bartok's widow residing in Hungary, since there was no "assurance that the beneficiary would have the benefit, use and control of the property sent to her."\textsuperscript{126} Four years earlier a court had also upheld a complaint by the President of the National Hungarian Government in exile against Credit Suisse, for wrongfully delivering to authorities of the Hungarian People's Republic a fund deposited by the National Government.\textsuperscript{127} The complaint was ultimately dismissed, however, on grounds

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{122} See id. at 211.
\item \textsuperscript{123} 111 N.Y.S.2d 75 (App. Div. 1952).
\item \textsuperscript{124} See id. at 77.
\item \textsuperscript{125} See id.
\item \textsuperscript{126} \textit{In re Bartok's Estate}, 215 N.Y.S.2d 818, 824 (Sur. Ct. 1961).
\item \textsuperscript{127} See Varga v. Credit-Suisse, 162 N.Y.S.2d 80 (Sup. Ct. 1957).
\end{enumerate}
\end{footnotesize}
of the statute of limitations.\footnote{128} 

\textit{In re Estate of Sage},\footnote{129} decided in January, 1979, reflected the changing place of the United States and its citizens in the world some two decades later. Cornelia Sage, upon her death in 1972, had established a spendthrift trust, with limited power to invade principle, in favor of her grandchildren. Then, in 1976, one of the grandchildren, "Henry Sage, Jr., also known as Ricky, and his wife, Karen were taken into custody by officials of the Brazilian Government and charged with the illegal possession of drugs."\footnote{130} The parties stipulated that Brazilian jails contained "primitive and brutal conditions including murders, sexual assaults, torture and abuse,"\footnote{131} which resulted in Ricky’s father spending $15,000 in medical and psychiatric expenses, $10,000 in fees to lawyers who negotiated with Brazilian officials, and $75,000 in bribes to obtain Ricky's and Karen’s freedom. The father, in turn, sought reimbursement from the trust.

The Court [did] not for a moment doubt the very real fear for the safety and well-being of these children. The papers paint a picture of prison life which humane individuals can barely comprehend. The Court is presented with a most brutal depiction of prison conditions. And these two Americans, beneficiaries of a substantial trust, found themselves thrown into such a foreign and inhuman environment. It is not necessary for this Court to delve into the cause or merits of the imprisonment itself; nor can it question the motives of a father's decision to employ this means to free his children from such intolerable and life threatening prison conditions. No father could do less.\footnote{132} Nonetheless, the Surrogate's humanitarianism, like that of his fellow citizens, came into conflict with his and their adherence to the rule of law. Thus, he could not sanction conduct which would be at worst punishable as a criminal offense if committed within this State, and at best, contrary to our public policy. Even if the Court were to accept the premise that the children were improperly jailed and that the only way to save their lives was to make illegal payments to obtain their release, such an expenditure of trust funds could not be authorized by a court of law in this State. . . . \footnote{133} If the trust provision itself explicitly authorized the use of trust funds for illegal purposes, or more specifically, to pay bribes, a court could not permit such use of trust funds.

Accordingly, reimbursement was allowed only for hospital expenses, but not for either the legal fees or the bribes.

The Court of Appeals reached seemingly inconsistent results six
months later in *Auerbach v. Bennett*,\(^{134}\) which involved $11 million in bribes and kickbacks made by General Telephone & Electronics Corporation and its subsidiaries in the United States and abroad between 1971 and 1975. The case was distinguishable from *Sage* in two respects: first, it involved a corporation rather than a trust; and second, a special litigation committee, consisting of directors who had not been members of the board at the time of the questionable payments, had decided not to pursue any claims for breach of fiduciary duty. In light, perhaps, of these distinctions, the Court held that the committee's decision fell "squarely within the embrace of the business judgment doctrine" and that to "permit judicial probing . . . would be to emasculate the business judgment doctrine as applied to the actions and determinations of the special litigation committee."\(^{135}\) Whatever the reasons for this holding, it must be noted that the language of the Court of Appeals differed markedly in tone from that of the trial judge in *Sage*. According to the *Auerbach* court, the decision of GTE to bribe mainly foreign officials involved the weighing and balancing of legal, ethical, commercial, promotional, public relations, fiscal and other factors familiar to the resolution of many if not most corporate problems. . . . [T]he courts cannot inquire as to which factors were considered . . . or the relative weight accorded them . . . the reasons for the payments, the advantages or disadvantages accruing to the corporation by reason of the transactions, the extent of the participation or profit by the respondent directors and the loss if any, of public confidence in the corporation which might be incurred.\(^{136}\)

The Court of Appeals expressed no concern whatever about sanctioning conduct that might be criminal if committed in New York. *Sage, Auerbach* and the other cases we have been analyzing were of little or no doctrinal significance. To the extent they addressed issues of doctrine, they resolved those issues in a straightforward fashion consistent with precedent. They are important for two other reasons. First, they reflect the changing position of the United States and its citizens in the World-War II and postwar world. Second, the cases show how significant issues of foreign relations were decided by state judges—mainly by trial judges sitting at the county level.

One final case similarly involved deciding a question of national policy by a local judge, in this case the Surrogate of Dutchess County. *In re Roosevelt's Will*\(^{137}\) raised the issue whether Franklin D. Roosevelt's 1938 announcement of his plans for the Franklin D. Roosevelt Library at Hyde Park and for the preservation of his presidential and other papers was sufficient to transfer to the Library and its ultimate head, the Archivist of the United States, not only the papers he already had delivered but also the "White House Central Files" and his "papers relating to the prosecu-

\(^{134}\) 393 N.E.2d 994 (N.Y. 1979).
\(^{135}\) Id. at 1002.
\(^{136}\) Id.
tion of the War, commonly known as the 'Map Room Papers.'” As of 1947, the White House Central Files had been transferred to Hyde Park, but the Map Room Papers remained “in Washington, D.C., under the custody of the President of the United States.”

On these facts, the local Surrogate held that the late President had “made a valid and effective gift of all his papers and files, including those in his possession at the time of death[,] to the United States Government, to be placed, maintained and preserved in the Franklin D. Roosevelt Library at Hyde Park, New York.” The court also addressed a June 1943 memorandum, in which Roosevelt “expressed a wish that a committee of three persons (Samuel I. Rosenman, Harry L. Hopkins, and Grace G. Tully or the survivors thereof) examine his personal papers, and select those which, in their opinion, should never be made public and those which should remain sealed for a prescribed period of time.” The Dutchess Surrogate concluded that this memorandum was “not testamentary in character,” but was “merely a request to the Director of the Franklin D. Roosevelt Library . . . as to the handling of the papers and files,” thereby raising “an administrative question for the Government of the United States and its Archivist, and not a judicial question for this Court.” Thus, these important questions of national policy were transferred from Poughkeepsie back to Washington, D.C., where they belonged.

Nonetheless, the law of fiduciary duty arose increasingly in the decades after World War II to resolve larger issues of public policy rather than merely the duty of one individual to hold and invest wealth for the benefit of another. The law of trusts was addressed, for example, in litigation over music performance rights between Broadcast Music, Inc. and the American Society of Composers, Authors and Publishers and over the use by live performers in New York and Los Angeles of moneys contributed to a trust fund for the performers by the recording, motion picture, and broadcasting industries. Another fiduciary duty case prohibited the sale of public school property to a church, on the ground that school trustees had a fiduciary duty to sell the land to the highest bidder even though voters who attended a public meeting preferred to sell to the church. Several cases dealt with job security and retirement rights of public employees, and a line of cases addressed litigation by real estate...
cooperatives and civic associations. Other cases involved a factional fight within the Democratic Party of the Sixteenth Assembly District of Brooklyn, a libel committed by a director of Aware, Inc., a membership corporation, and a claim by the National Committee on the Observance of Mother’s Day for breaches of fiduciary duty by its advertising agency. These cases, again, involved no significant doctrinal development, but they are important because they show how old law developed for adjudicating private disputes was put to broader and more public uses in the half century following World War II.

*Hyman v. Jewish Chronic Disease Hospital* is an excellent illustration of the new uses to which old doctrine was being put in the second half of the century. The old doctrine had affirmed the unqualified right of current directors of both business and not-for-profit corporations to examine corporate books and records to enable them to perform their duties. Relying on this established doctrine, Hyman as a director sought access to hospital records involving cancer experiments on patients. Under a program financed by the U.S. Public Health Service and the American Cancer Society, two doctors had injected foreign cancer cells into twenty-two hospital patients in an effort to determine whether their immune systems would reject the cancer. The patients had consented to the injections, but they had not been “told that the injection was of cancer cells because the doctors did not wish to stir up any unnecessary anxieties in the patients.” On these facts, the trial court held the director entitled

---


151. 206 N.E.2d 338 (N.Y. 1965).


FIDUCIARY DUTY IN NEW YORK

Each extension of the law of fiduciary duty into areas involving issues of public policy encouraged lawyers, of course, to seek further extensions. It is unclear how far fiduciary law would have extended if judges had been more supportive of its extension. But, as the divergent results in the cases we have been examining suggest, judges were largely indifferent. Indeed, in one key line of cases, the courts opposed using concepts of fiduciary duty to attain desired public policies, even when the policies had been enacted legislatively.

The first case in the line was *Hornstein v. Paramount Pictures, Inc.*,157 in which shareholders brought a derivative suit against Paramount's directors to compel them to restore to the corporation a $100,000 payment out of corporate funds made to two labor union officials in order to induce them not to call a strike. Plaintiffs claimed that the payment violated section 380 of the Penal Law, which provided that anyone "who gives ... any money ... to any duly appointed representative of a labor organization ... to induce him to prevent or cause a strike ... is guilty of a misdemeanor,"158 and the court agreed that, if the $100,000 had been given freely as a bribe, it would have been an unlawful expenditure of corporate funds, and the directors would be required to restore it to the corporation.159

The court, however, had "no difficulty or hesitancy" in finding that the board "was not the giver of a bribe but a submitter to extortion."160 In particular, it made the following specific finding about the defendant Keough, the vice president and general counsel of Paramount who orchestrated the board's decision to pay the $100,000, and William Bioff, the union official who received it:

Keough had been an employee of Paramount since about 1919, and an officer and director and counsel since 1932. He was regarded by his associates, the other officers and directors, as honest and trustworthy and loyal and capable. In yielding to Bioff's demands and making the payments he act[ed] upon the belief, honestly and in good faith entertained by him, that in so doing he was promoting the interest of the corporation he was serving by saving it from ... actual bankruptcy, and the facts and circumstances existing at the time and known to him afforded a reasonable basis for that belief. It was a belief which under the circumstances an honest and diligent officer and director of that corporation reasonably could entertain, and

158. Id.
159. See id.
160. Id.
(161) See id.


(163) 55 N.E.2d 740 (N.Y. 1944).

(164) 38 N.Y.S.2d 270 (Sup. Ct. 1942).

(165) Id. at 273.

(166) Id.

(167) 51 N.E.2d 681 (N.Y. 1943).

(168) Id. at 688.

This refusal to extend doctrine so as to make fiduciaries liable for regulatory breaches committed in a good faith belief that they were furthering the interests of their beneficiaries was not preordained. Indeed, one early case, decided by a trial court in upstate Erie County, had reached the opposite result when it required a man who was the manager of a business, as well as a member of its board of directors, to reimburse the business for $800 in bribes paid to local officials to overlook violations of the Sunday closing laws.\textsuperscript{170} More recently, another trial judge had declared that bank directors were duty-bound to abide by state banking regulations, although he had declined to allow a shareholder to maintain a suit for damages in a context in which the corporation had suffered no damages and had come into compliance with the law.\textsuperscript{171} On the other hand, the refusal to hold fiduciaries liable for regulatory breaches was consistent with the cases discussed in Part II above, which strove to enhance entrepreneurial freedom. The refusal also reflected a general tendency on the part of common-law judges in the decades after 1940 to recede from regulatory activities when legislatures entered a field and established complex regulatory structures. Whether they were acting out of a growing distrust of the emerging regulatory state\textsuperscript{172} or out of an anti-progressive desire to limit the impact of the New Deal’s often redistributive legislation, the refusal of New York’s judges to bring the weight of fiduciary duty to bear in support of regulatory enforcement weakened that enforcement significantly.

To appreciate the weakness, one need only focus on the weighing of risks in which a corporate officer or director had to engage in evaluating corporate behavior which might later be found to violate a regulatory statute. Typical regulatory sanctions consist of orders granting prospective relief, fines imposed on the corporate business entity, and occasionally fines or minor criminal penalties imposed on corporate fiduciaries. Often, the heaviest burden on a business subject to possible regulation will be the legal expenses and similar costs incurred in fending it off. In the world created by the \textit{Hornstein, Simon,} and \textit{Kalmanash} cases, fiduciaries could decide how to respond to prospective regulation without fear of suffering serious personal liability. They were freed thereby to make an entrepreneurial judgment, weighing possible corporate profits against possible corporate regulatory losses, with knowledge that both profits and losses would be spread among all shareholders. Thus, fiduciaries could opt against regulatory compliance if prospective profits seemed sufficiently high. Making them personally liable as fiduciaries for all corporate costs incurred at the hands of regulators, as the plaintiffs in \textit{Hornstein, Simon,} and \textit{Kalmanash} proposed, would have altered this decisional balance. By imposing costs on directors and officers, while leav-

\textsuperscript{170} See Roth v. Robertson, 118 N.Y.S. 351 (Sup. Ct. 1909).
ing profits spread among all shareholders, the proposed rule would have made fiduciaries much more concerned with avoiding costs than with earning profits, would have forced them more frequently to obey regulatory legislation, and thereby would have increased regulatory compliance at the cost of entrepreneurial activity. The Court of Appeals, however, refused to sanction such a balance by allowing an expansion of fiduciary law into a device for enforcing regulatory, often redistributive legislation. Instead, it continued to assign fiduciary law a more limited role.

As a result of the Court's refusal to place the law of fiduciary duty in service of the regulatory state or otherwise to change the black-letter standard of fiduciary responsibility to any significant extent, the law, at bottom, remained committed to insuring that private managers of private investments acted honestly and with due diligence. As a result, the law of fiduciary duty in 1980 did not differ greatly from what it had been in 1920. Courts had applied it to occasional cases involving international and other public policy issues and thereby somewhat expanded its scope. They also had subtly changed the law's application so as to make it more pragmatic and sensitive to the business and financial needs of both fiduciaries and beneficiaries and more tolerant of entrepreneurial activities designed to increase income or grow principal. Most important, however, were changes that the New York courts had refused to put into place.
Article