MEMORIAL FOR

HARRISON EARL FRYBERGER

January 10, 1867 – October 19, 1952

Memorial Services
Hennepin County Bar Association
Minneapolis, Minnesota
1953

Harrison Earl Fryberger

1867 - 1952

Harrison Earl Fryberger, attorney at law and economist, was born at Featherstone, Minnesota, January 10, 1867, the son of William Fryberger and Margaret (Burroughs) Fryberger. His early education was obtained in Minnesota after which he entered the University of Minnesota. He was graduated by that university in 1890 with an A. B. degree, at which time he was selected as the class orator, and in 1892, the same university with a degree of L.L.B.

After graduation he engaged in the general practice of law in Minneapolis having been admitted to practice in 1892. He continued in the general practice of law, in Minneapolis until 1929, during which time he was a member of the Minnesota House of Representatives from 1903 to 1905. As a legislator he sponsored and was the author of the Fryberger Gross Earnings Law. The passage of this law increased taxes of railroads about one third.

In 1931, he moved to New York City and remained there until 1944 engaging in the general practice of law in that city, after which he returned to Minneapolis where he was resident until his death. During his years he devoted some of his time and energy to economic problems. While living in New York he traveled to Europe for the purpose of studying economic problems of the European countries in which he traveled. In 1931 he published "The Abolition of Poverty" of which he was the author and in 1932, another book called "Riches for all". He also published two brochures, "No Third Term for Roosevelt", and a supplement, "No third term".

A goodly share of his legal activities in his active practice of law were centered about his specialty in representing minority stockholders in

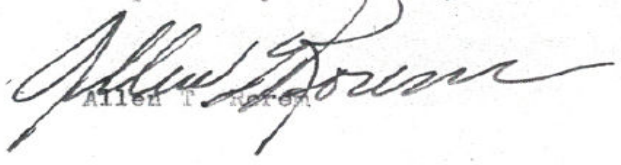
litigation. To some he was regarded as an authority of this phase of the law. He was active in litigation between H. N. Backus et al [and] M. L. Finkelstein et al, one case reported at 23 Fed 2nd 357, the other 23 Fed 2nd 531. These cases involved many technical legal points including Fraud, Misrepresentation, Fiduciary relations. The court held that the majority stockholders are in duty bound to without discrimination exercise the utmost good faith in the control and management of the of the affairs of the corporation in relation to the rights of the minority shareholder. The case was bitterly fought and resulted perhaps in one of the largest judgments rendered in favor of minority stockholders in that type of action up to that time.

On his return from New York City he devoted considerable time and effort to wage and hour litigation, many of which cases were brought against the Federal Cartridge Company.

He was an unusual character, well known for his intense interest in litigation carried on by him in behalf of his clients far beyond the questions involved in the particular case then under consideration.

He was a charter member of Delta Chi fraternity, member of the Hennepin County and Minnesota State Bar Association, and a member of the New York Bar. His hobby was work. A brother, H. B. Fryberger, who practiced in Duluth, Minnesota predeceased him. He died October 19, 1952, having remained a bachelor all his life. He leaves a cousin, Raymond H. Fryberger, a member of the Bar of Minnesota, and a sister, Helen Fryberger, who was a teacher in the Minneapolis Public schools, now retired.

Respectfully submitted,



Allen T. Rorem

Prepared by
Allen T. Rorem

Appendix

He ran in the Republican primary in 1900 for the state House, but came in fifth in a "top four" election. * He was elected on November 4, 1902 to represent the Forty-first District in the Minnesota House of Representatives. This district consisted of the Fifth and Sixth Wards of Minneapolis. Four Representatives were elected. In other words it was a "top four election."

L. C. Stevenson, R.....3,125
Winfield W. Bardwell, R 3,120
Arthur L. Helliwell, R.....3,037
Harrison E. Fryberger, R 2,914
Alonzo Phillips, D.....2,778
George E. Ricker, D 2,256
Charles A. Willen , D 2,167
Daniel A. Fullon, D 2,114
A. A. Graves. Pro.....235 **

He did not seek re-election in 1904. His major legislative accomplishment was the "Fryberger Gross Earnings Law" (1903 Laws, c. 253, at 375). Section Six requires the law to be submitted to the voters in 1904. It was not. It follows.

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*The primary on September 18, 1900, was a "top four" contest:

William D. Washburn, Jr.....2,194
Samuel V. Morris, Jr.....1,766
Loren C. Stevenson.....1,400
Joseph L. Dobbin.....1,170
H. E. Fryberger.....1,145
Julius Newgord.....1,115
R. H. Crafts.....970
W. Gunderson.....946
J.M. Hazen.....912

Minneapolis Journal, September 20, 1900, at 6.

** 1903 Blue Book, at 525.

CHAPTER 253.

H. F. No. 422.

An act providing for the taxation of railroad properties, the collection of such taxes and repealing acts inconsistent therewith.

Taxation of railroad properties.

Be it enacted by the Legislature of the State of Minnesota:

SECTION 1. Every railroad company owning or operating any line of railway situated within, or partly within, this state, shall during the year 1905, and annually thereafter pay into the treasury of this state in lieu of all taxes and assessments upon all property within this state, owned or operated for railway purposes by such company, including equipment, appurtenances, appendages and franchises thereof, a sum of money equal to four (4) per cent of the gross earnings derived from the operation of such line of railway within this state; and the annual payment of such sum shall be in full and in lieu of all other taxes and assessments upon the property and franchises so taxed. The lands acquired by public grant shall be and remain exempt from taxation until sold or contracted to be sold, or conveyed, as provided in the respective acts whereby such grants were made or recognized.

Four per cent of gross earnings.

Land grants, exempt, until sold or contracted to be.

SEC. 2. The term "the gross earnings derived from the operation of such line of railway within this state," as used in section 1 of this act is hereby declared and shall be construed to mean, all earnings on business beginning and ending within the state, and a proportion, based upon the proportion of the mileage within the state to the entire mileage over which such business is done, of earnings

Gross earnings defined.

on all interstate business passing through, into or out of the state.

SEC. 3. All acts and parts of acts not inconsistent herewith regulating the payment, collection, time of payment, enforcement or reports involving the amount of taxes upon the gross earnings of railroad companies within this state, or providing penalties for the non-payment of such taxes, are hereby made applicable to this act so far as may be; and all acts and parts of acts inconsistent with the provisions of this act are hereby repealed.

Enforced payments.

SEC. 4. Upon failure to pay the amount of such taxes legally due upon the date heretofore provided by law for the payment thereof, in addition to existing remedies, collection may be enforced in a civil action brought in the name of the State of Minnesota in the district court of any county.

Contesting validity of this act.

SEC. 5. Before any railroad company shall be heard to contest or continue to contest the validity of this act or any part thereof, such railroad company shall as a condition precedent thereto, pay into the treasury of the State of Minnesota, the amount of taxes due or payable from such railroad company under the existing tax laws of this state applicable to such company.

Submission to voters.

SEC. 6. This act shall be submitted to the people of this state for their approval or rejection at the next general election for the year 1904.

Ballot.

The secretary of state shall cause to be printed in bold type upon the ballot used in voting for state officers or upon a separate ballot, if so provided by law at the said election, in manner conformable with the requirements of the general election law, the words, "For increasing the gross earnings tax of railroad companies from three to four per cent.

Yes .....

No ....."

And each voter voting at such election shall designate his vote by a cross mark made opposite one or the other of the words "Yes" or "No" and the said elector shall in all respects, conform, as far as may be, to the requirements of the general election law, and the returns of said election shall be made, canvassed and certified, and the results thereof declared in the manner provided by law for returning, certifying and canvassing votes cast for state officers.

Return and canvass.

SEC. 7. This act shall take effect and be in force from and after its passage.

Approved April 18, 1903.

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The "wage and hour" cases in which Harrison E. Fryberger represented employees of Federal Cartridge Company are reported at:

Anderson v. Federal Cartridge Corp., 62 F. Supp. 775 (D. Minn. 1945) (Joyce, J.), affirmed 156 F.2d 681 (8th Cir. 1946).

Anderson v. Federal Cartridge Corp., 72 F. Supp. 639 (D. Minn. 1947). (Nordbye, J.).

Anderson v. Federal Cartridge Corp., 72 F. Supp. 644 (D. Minn. 1947) (Vogel, J).

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The cases in which he represented E. N. Backus and other minority shareholders against H. L. Finkelstein, et al. are reported at:

BACKUS et al. v. FINKELSTEIN et al.
23 F.2d 531 (D. Minn. 1924).
It is posted below, on pages 8-17.

BACKUS et al. v. FINKELSTEIN et al.
23 F.2d 357 (D. Minn. 1927).
It is posted below, on pages 18-30.

23 F.2d 531 (1924)

BACKUS et al.
v.
FINKELSTEIN et al.

District Court, D. Minnesota, Fourth Division.
March 19, 1924.

H. E. Fryberger, of Minneapolis, Minn., for plaintiffs.

Doherty, Rumble, Bunn & Butler, of St. Paul, Minn., for defendants.

BOOTH, District Judge.

In the memorandum attached to the order filed in this suit on September 8, 1920, it was held by this court that the suit was a stockholders' suit, brought on behalf of the corporation, the Miles Theater Company, for the recovery of assets diverted from it by wrongful action on the part of the individual defendants. It was also held that the complaint showed a sufficient compliance with equity rule 27 to enable suit to be maintained. That such suits are maintainable, where there has been mismanagement, fraudulent acts, misappropriation of corporate funds or assets, or diversion of funds, is well settled. C. J. vol. 14a, p. 155; Hawes v. Oakland, 104 U.S. 450, 26 L. Ed. 827; McMullen v. Ritchie (C. C.) 64 F. 253; Ranger v. Champion Co. (C. C.) 52 F. 611; Streight v. Junk (C. C. A.) 59 F. 321; Pencille v. Ins. Co., 74 Minn. 67, 76 N.W. 1026, 73 Am. St. Rep. 326; Tasler v. Peerless Co., 144 Minn. 150, 174 N.W. 731.

It was further held by this court that the joinder, as plaintiffs, of the parties who had been at one time stockholders in said company, but who alleged in the bill that they had parted with their stock by reason of wrongful acts and representations by the individual defendants, and further alleged that they now seek to rescind the sales of their stock, and to be restored to their status as stockholders, was proper, and that, if the facts should warrant, relief could be afforded in respect to the cause of action in behalf of the corporation, and also incidental relief to the stockholders seeking restoration of their original status. Price v. Union Land Co. (C. C. A.) 187 F. 886, was cited.

Evidence has been taken, both by deposition and in open court. Upon the trial it was stated by the court and acquiesced in by both parties that the issues involved in the alleged cause of action on behalf of the corporation would first be taken up and, if possible, disposed of, reserving for future consideration the issues in the causes of action in behalf of the plaintiffs who seek restoration of their ***533** status as stockholders. In accordance with this understanding, the cause of action in behalf of the corporation has been submitted, and it is that cause of action that I shall consider at the present time.

In the bill of complaint a large number of charges of mismanagement and wrongdoing on the part of the individual defendants are made, among them, the keeping of an inadequate set of books; the keeping of a false set of books; the sending out of false financial statements to the stockholders; the taking of large and exorbitant salaries by the defendants, Finkelstein, Ruben, and Hamm; the charging of excessive prices to the New Garrick Theater in Minneapolis, which was operated by the Miles Theater Company, for moving picture films; the making use of the New Garrick Theater as a feeder for numerous other theaters owned, or controlled and operated, by said individual defendants; the charging up to expenses of the New Garrick Theater amounts paid for moving picture films which were never shown at said theater, but which were shown at other theaters owned or controlled and operated by said individual defendants, without adequate payment for the use thereof; the converting to their own use large sums of money by the individual defendants Ruben and Finkelstein from funds of the Miles Theater Company; the payment of individual debts of defendants Finkelstein and Ruben with funds of the Miles Company; the mortgaging of property belonging to the Miles Company for the benefit of Finkelstein and Ruben.

It will not be necessary to discuss all of these charges in detail at this time. The short facts in the history of the Miles Theater Company, as disclosed by the evidence, are as follows:

It was incorporated under the laws of South Dakota in August, 1911, and was authorized shortly thereafter to do business in the state of Minnesota; the authorized capital stock in the first instance was $250,000, which was shortly increased to $350,000. The par value of the shares was $10. In consideration for the transfer of property to the corporation, Charles H. Miles became the owner of 24,995 shares of the capital stock, and a considerable portion of these shares, as well as of the remaining shares, was sold to various parties, especially in the city of Detroit, Mich. The company operated the theater then known as the Miles Theater in 1912, 1913, and 1914. Dividends amounting to 9 per cent. were paid in 1912, 12 per cent. in 1913, and 3¼ per cent. during the first half of 1914. It may well be doubted, however, from the evidence, whether these dividends were paid wholly from earnings.

In 1914 Finkelstein and Ruben, who were then engaged in operating theaters in Minneapolis and St. Paul, arranged with D. L. Bell that he should purchase the controlling interest in the Miles Theater Company on their behalf. Accordingly, in December, 1914, Bell purchased from Miles 17,501 shares of the stock of the company. The arrangement by which Bell should turn the stock over to Finkelstein and Ruben was modified, and the stock continued to be held by Bell until the fall of 1915. Meanwhile, in December, 1914, the old directors of the company resigned, and Bell, Ruben, Finkelstein, McCormick, and J. M. Bell were elected in their places. In November, 1915, D. L. Bell reached a settlement with Ruben and Finkelstein and resigned as director. McCormick resigned at the same time. Thereupon Sarah Blumenthall, an employee of Ruben and Finkelstein, and H. E. Billings, also an employee, were elected directors to fill their places. At the first meeting of the board of directors, after the stockholders' meeting in September, 1916, Ruben was elected

president of the company, Finkelstein treasurer, and Sarah Blumenthall secretary. The same officers were continued until September, 1918, when H. J. Charles was elected a director and made secretary of the company, and these three officers have been continued in office from that time.

On September 7, 1920, defendant Hamm was elected a director, and has been continued as such since that time. By September, 1915, Finkelstein and Ruben had acquired 17,591 shares of the stock of the company; by September, 1916, 18,776 shares; by September, 1917, 19,878; by September, 1918, 28,741 shares, 18,773 of which stood in the name of the New Palace Theater Company, which was owned or controlled by Finkelstein and Ruben; by September, 1919, 34,086 shares, 34,080 of which stood in the name of the Twin City Amusement Trust Estate, which is a common-law trust, organized in October, 1918, the sole beneficiaries of which are Finkelstein, Ruben, and Hamm; by September, 1920, 34,230 shares stood in the name of said trust estate; by September, 1921, 34,630, at which figure it has remained.

As has been stated, dividends were paid in 1912, 1913 and the first half of 1914. No further dividends were paid until April, 1920, at which time a dividend of 10 per cent. was paid; in October, 1920, a dividend of 10 per cent. was paid; in January, 1921, a dividend ***534** of 10 per cent. was paid; and in September, 1921, a dividend of 20 per cent. was paid. At the time these dividends were paid the stock holdings were such that $173,001 was paid to the Twin City Amusement Trust Estate and $1,974 was paid to other stockholders.

The Books of Account.

The charge is made that a false set of books was kept prior to 1920. To support this charge, evidence was introduced that two books, other than those which were produced upon the trial, had been kept, namely, a perpetual balance book and a private ledger; also testimony which apparently showed that their contents differed materially from the figures shown by the books, papers, and other data produced upon the trial. The keeping of such books was denied on the part of the defendants.

In view of the production of such original books as were claimed by the defendants to have been kept by the Miles Company, together with other records, papers, and data which, taken together, contained such full and complete information that a set of books could be and has in fact been made therefrom, without apparent discrepancies or omissions, and in view of the fallibility of the testimony of witnesses as to the contents of the alleged missing books, I am constrained to the conclusion that the charge of keeping a false set of books has not been sustained by substantial proof.

Inadequacy of the Books Kept.

In my judgment the evidence sustains this charge. The character of the books kept and produced upon the trial, the fact that a great deal of the information usually kept in regular books of account was contained in loose sheets or other memoranda, the fact that the defendants, either for their own private information or for the purpose of this

trial, saw fit to have a complete set of books drawn up from the books, papers, loose sheets, and memoranda of the defendant company, are convincing evidence that the books actually kept by the company were in themselves inadequate, and such that the average man, unless he were a bookkeeper, would be unable to obtain either complete or accurate information as to the business of the company. As to the set of books drawn up by Temple, Webb & Co. from the original books and papers of the company, I may say, in passing, that a careful examination of them leads me to the conclusion that they were prepared with great care, and, so far as I have checked them up with the original data, they appear to be accurate and complete, and the same may be said of the compilations made by Temple, Webb & Co. and introduced in evidence as Defendants' Exhibit 20. This is said without intending in any way to disparage the compilations prepared by Mr. Aaen and by Mr. Martinson, which were introduced on behalf of the plaintiff. These latter compilations and statements were, as the evidence shows, prepared without their authors having available all of the books, records, and data which were available to Temple, Webb & Co. Many of the discrepancies which appear between the two sets of compilations are in my judgment due to this fact.

As to False Financial Statements.

This charge is based largely upon the three annual statements introduced in evidence as Plaintiffs' Exhibits 3, 4, and 5, purporting to be condensed balance sheets for periods ending November 22, 1915, August 28, 1916, and August 27, 1917. These statements are attacked as being knowingly false, and as having been sent out with the intent to deceive stockholders. Exhibit 5, for the year ending August 27, 1917, is the one which has been most dwelt upon. The statement is certainly open to criticism as being extremely meager, and it shows on its face that it was not gotten up by an expert bookkeeper. It is claimed that the statement is false, in that it does not show among the assets the amount of $14,000 represented by checks for $10,000, $3,000, $600, and $400, which had been drawn in favor of Finkelstein and Ruben, and which it is claimed were unauthorized withdrawals by them from the moneys of the company. While these items do not all appear in the statement as assets of the company, it is nevertheless claimed on behalf of the defendants that the amounts are reflected either in the item "Film binder reserve fund," $8,000, or in the item "Expenses advanced, $7,605.93," so far, at least, as the amounts of the above-mentioned checks were still unreturned to the company. It is, however, admitted by the expert accountant, who testified on behalf of the defendants, that better bookkeeping would have placed $9,000 of these items among the assets as bills receivable.

It is further claimed that the assets in this statement should have shown $21,400, representing "capital improvements," which had been added to the property. It must be borne in mind, however, that this financial statement, Exhibit 5, is supposed to have been made up in accordance with the system of ***535** bookkeeping then actually in use, and not in accordance with what a scientific bookkeeping method would have required. Even experts differ as to what items are proper to go into capital account, and what into repairs and maintenance account. In this very case the expert who testified for the plaintiffs contended that the amount of $21,400 should have been included in capital

account, whereas the expert for the defendants found such items to have been only approximately $12,000. But the bookkeeper at the time for the defendants, not having kept such an account in the books, naturally did not segregate such items in the annual statements, but lumped all the items under the head of "Expenditures."

It is further claimed that an item of "assets" should have appeared, amounting to approximately $5,800, for films paid for by the Miles Theater Company and charged up to the New Garrick, but which were not shown at that theater. The same observation may be made here as in reference to the preceding item, namely, that, inasmuch as no such segregated item appeared on the books, naturally enough it would not appear in the annual statement. This item, however, unlike the former, cannot be looked at merely from a bookkeeping standpoint. Whether such sum was actually paid out of the Miles Company funds and charged as expenses of the New Garrick Theater, from which the New Garrick received no benefit, is a question which must be answered on its merits, and will be considered later on. Leaving out of consideration this item, therefore, for the time being, the evidence as to the making up of Exhibit 5, when considered fairly and in the light of the system of bookkeeping then in vogue by the Miles Theater Company, is not such that I am ready to conclude that the statement was knowingly false, and made for the express purpose of deceiving the stockholders.

Moreover, a comparison of these several statements, Exhibits 3, 4, and 5, with the actual condition of the company's finances on the dates of the statements, as shown by Temple, Webb & Co., in its reconstructed set of books and in its compilation, Defendants' Exhibit 20 appears to show that the yearly statements, Exhibits 3, 4, and 5, recorded with substantial accuracy the business of the Miles Theater Company for the respective years, when it is borne in mind that the figures were made up on what is known as the "cash in and out system," and in disregard of the classification of certain expenditures as belonging to capital account, and in disregard, also, of depreciation of building and equipment. Inasmuch, however, as evidence which may be hereafter received upon issues not yet tried may throw further light upon the character of these statements, Exhibits 3, 4, and 5, and the intention of their authors in preparing them, I make no final conclusion in regard to these statements at the present time.

Payment for Films Charged to New Garrick, but Not Shown There.

The evidence shows, and it is conceded, that many films were bought and paid for which were charged to the expenses of the New Garrick, which were not there shown, but were shown in other houses owned or controlled by Finkelstein, Ruben, and Hamm. The explanation given by the defendants is this: That film-producing companies oftentimes would sell their films only in groups, so that, in order to get one or two good films, suitable for the New Garrick, numerous other films in the group would be purchased; that this naturally left on hand many films unsuitable for the New Garrick; that some of these were used at other houses owned or controlled by Finkelstein, Ruben, and Hamm; that, for the use of the films by these other houses, payment was made in some instances, and in others, not, according as it appeared that the house could afford to pay for the film.

It may be that this arrangement was beneficial to all parties concerned, and it may also be that it was strictly fair and honest; but such an arrangement had in it an inherent vice. It was an arrangement by the defendants as directors and managing officers of the Miles Company with themselves as managing officers and directors of other companies. Such contracts or agreements are not necessarily void, but they are always viewed with the closest scrutiny, and must be always open to investigation, and may be set aside if unfair. The burden is upon the party seeking to uphold the contract. C. J. vol. 14a, p. 126; Corsicana Bank v. Johnson, 251 U.S. 68, 90, 40 S. Ct. 82, 64 L. Ed. 141; Marcy v. Dev. Co. (D. C.) 228 F. 150; Geddes v. Anaconda Co. (C. C. A.) 245 F. 225.

Transactions of this nature took place during a period of years. The amounts paid by the Miles Company for such films amounted to upwards of $10,000. I am unable to say from the evidence adduced that these deals were free from any taint of unfairness towards the Miles Company. It does not relieve the situation to say that the defendants Finkelstein, Ruben, and Hamm, through their ability, bought the films for the Miles Company at much less than other theater companies ***536** similarly situated could buy them. If these defendants were able to do this, it was their duty to do it, for they were directors, received a salary for their services, and were bound to use their best efforts for the interest of the Miles Company. The fact that they were able to buy advantageously, and did so, cannot excuse laxity on their part in making agreements for the use of such films as could not be shown at the New Garrick. Whether the utmost fairness was shown to the Miles Company in these transactions, whether they were entered into and carried out in the highest good faith, can only be determined by an examination of the particular transactions, and of all the surrounding facts and circumstances under which the transactions were entered into and carried out. An accounting will be necessary to determine the rights of the Miles Company in regard to these transactions.

Exorbitant Charges for Films Shown at the New Garrick.

It is claimed by the plaintiffs that the defendants Finkelstein, Ruben, and Hamm, through an organization of film distributors, in many instances controlled the prices which were paid by the Miles Company for films shown at the New Garrick, and that in other instances they made unfair agreements to pay for films at higher prices for the New Garrick than they paid for the same films for other theaters owned or controlled by them, situated in St. Paul. In my opinion, neither of these charges is sustained by the evidence. The evidence does not show that the defendants Finkelstein, Ruben, and Hamm, either separately or together, had any such interest in or authority over the film-distributing companies that they were able to fix prices to be charged to the New Garrick for the films purchased for it; nor do I think the fact that agreements were entered into by the said defendants, paying much higher prices for the same film when used at the New Garrick than when used at the corresponding theater in St. Paul, necessarily shows either bad faith or bad management on their part. That the charges for the same films in St. Paul were materially less than in Minneapolis was a fact well understood in the motion picture business, and the reasons for this difference were fully

given and satisfactorily explained by the witnesses who testified, and who are intimately acquainted with local conditions. Moreover, the prices paid for films to be shown in the New Garrick in Minneapolis compared very favorably with prices for the same films in most other cities of the same class.

There remains, however, a third class of films, viz. those which were purchased by said defendants under a so-called blanket contract, by virtue of which said defendants themselves allocated the price to be paid by the New Garrick of Minneapolis, and by any other theater owned by them where the film was shown. As to these particular films, said defendants were acting as managing officers both for the Miles Company, and for any other theater owned and controlled by them at which the films were to be shown. In these cases the defendants were in effect making contracts for and with themselves, and these contracts must therefore be viewed with the closest scrutiny. If these contracts were actually made with the utmost good faith, they may stand; otherwise, an adjustment must be had in respect to them. Each of such contracts must stand upon its own merits. On account of this matter there must also be an accounting.

Conspiracy to Oppress the Minority Stockholders.

It will not be necessary to discuss this charge at this stage of the litigation. We are now engaged upon the issue whether the defendants Finkelstein, Ruben, and Hamm should account for assets which properly belong to the corporation. The question whether said defendants also conspired to oppress the minority stockholders is one the bearing of which upon the issue now under investigation is mainly indirect, and for that reason I deem it unnecessary to discuss that question at this time.

Excessive Salaries.

The salaries of Finkelstein and Ruben, commencing with January 18, 1915, were $100 per week each. This was at first paid by the treasurer without authority; but in May, 1915, these payments were ratified by the board of directors, which then consisted of D. L. Bell, J. M. Bell, McCormick, Ruben, and Finkelstein. This salary so fixed continued until February, 1916, at which time it was raised to $150 per week each, to commence February 28, 1916. The directors who voted in favor of this were Finkelstein, Ruben, Billings, Blumenthall, and Dyer. Billings and Blumenthall, as has already been noted, were employees of Finkelstein and Ruben. This salary has been continued at the same figure ever since. In September, 1918, the stockholders passed a resolution ratifying the act of the board of directors in ***537** employing the defendant Hamm at $150 per week from April 29, 1918, and authorizing the directors to continue the employment at the discretion of the board. I have been unable to find in the record any action in regard to this matter, by the board of directors, prior to this resolution of the stockholders.

In September, 1920, defendant Hamm was elected a director. On September 7, at a meeting of the board of directors, the salaries of the officers were fixed at the figures theretofore paid. Directors Ruben, Finkelstein, Blumenthall, and Charles voted on this motion. Mr. Hamm was absent from the meeting. It may be open to serious question

whether the resolutions fixing the salaries of these several officers were of any validity, in view of the control which Finkelstein and Ruben, and later on Hamm, had in the passage of the resolutions. Corp. Jur. 14A, pp. 143, 144; Jones v. Morrison, 31 Minn. 140, 16 N.W. 854; Davis v. Memphis Railway (C. C.) 22 F. 883.

But, whether the resolutions were themselves void or not, salaries fixed under such circumstances are certainly open to investigation. Harrison v. Thomas (C. C. A.) 112 F. 22. During all of the period when these salaries were paid, there were numerous other officers also drawing salaries from the Miles Theater Company a manager, an assistant manager, a bookkeeper, and a cashier. Their salaries totaled approximately $6,000 per year. It is true that evidence was introduced at the trial tending to show that the salaries to Ruben and Finkelstein, even at the high figure, were reasonable. On the other hand, there was evidence showing that at other theaters similarly located the salaries were very much smaller.

I do not undertake to say what the value of the total services which might be rendered by Finkelstein, Ruben and Hamm to moving picture theaters might be, in case the companies were of such size and the business of such magnitude as would warrant the paying of the full price for such services; but it must be borne in mind that the Miles Company, on the face of the showing made by the defendants' statements, was a struggling theater, at least up to 1920. Corporate directors and officials, in fixing their own salaries, must have some regard for the financial condition of the corporation. It must also be remembered that Finkelstein and Ruben, and later on the Twin City Amusement Trust Estate, were majority stockholders of the Miles Company, acting in concert. As such they occupied a fiduciary relation to the minority stockholders, and were bound to exercise good faith, care, and diligence to protect the rights of the minority. Jones v. Missouri Co. (C. C. A.) 144 F. 765; Stebbins v. Michigan Co. (C. C. A.) 212 F. 19; Hyams v. Calumet Co. (C. C. A.) 221 F. 529; Union Pac. Co. v. Frank (C. C. A.) 226 F. 906, 920.

It may also be noted that during this time Finkelstein and Ruben and Hamm were drawing weekly salaries from a number of other theaters owned or controlled by them. In view of the condition of the Miles Theater Company, and in view of the services actually rendered by these three defendants, I have reached the conclusion that the sum of $10,000 per year from January 18, 1915, is all that ought to be allowed as their total compensation. In my opinion, the taking of these high salaries by these defendants was merely a convenient method for absorbing the profits, instead of simply making payment for actual services performed.

There must be an accounting on account of the matter of salaries. In fixing the amount of compensation allowable, I have proceeded upon the assumption that Finkelstein, Ruben, and Hamm were actually performing the services which they rendered to the Miles Theater Company in good faith, and were not guilty of any intentional wrongdoing against the corporation or the minority stockholders. If it shall hereafter appear from the evidence that this assumption is not well founded, and that said defendants were guilty of intentional wrongdoing toward the corporation as such directors, or of willful oppression of the minority stockholders, then the question will be open for

determination whether any compensation whatever should be allowed said defendants. In this connection I may add that nothing in the evidence has been brought to my attention which would indicate that the defendant Hamm has been guilty of any intentional wrongdoing against the Miles Theater Company or the minority stockholders.

Loans to Finkelstein & Ruben.

The evidence shows that, commencing as early as 1917, certain amounts of money were paid to Finkelstein and Ruben from the funds of the Miles Company. About $14,000 up to August 27, 1917; $27,000 during the year ending August 26, 1918; $43,000 during the year ending August 23, 1919; $123,000 during the year ending August 30, 1920; $88,000 during the year ending September 3, 1921, During the latter years, the payments were made to the Twin City Amusement Trust Estate. It is claimed by the defendants that ***538** these withdrawals were loans, and that they were all repaid. Assuming that they were loans, yet, inasmuch as they appear to have been in violation of the laws of South Dakota (which became part of the Miles Company's fundamental law), and furthermore were for unusually large amounts, and, so far as appears, were never authorized by the board of directors, these various transactions are subject to the closest scrutiny, for the purpose of seeing what the exact amounts were; whether they were all repaid, with interest; and, further, whether the purposes to which the moneys thus borrowed were put by the borrowers were inimical to the best interests of the corporation. An accounting is necessary on account of this matter also.

The Bell Mortgage.

A certain mortgage of about $52,000 was on the Miles property when Bell bought the controlling interest in the stock. This mortgage had been personally assumed by Miles, and it was agreed that it should be assumed by Bell. On the transfer of the stock to Finkelstein and Ruben, it was agreed that the mortgage should be assumed by them. It is charged that this mortgage was paid afterward, in part or in whole, out of funds of the Miles Company; in my opinion, the evidence does not sustain this charge.

Capital Trust and Savings Bank Mortgage.

In November, 1916, a mortgage for $250,000 was made by the New Palace Theater Company of Minneapolis and the New Princess Theater of St. Paul to the Capital Trust & Savings Bank. It is charged in the bill of complaint that Finkelstein and Ruben caused real and personal property belonging to the Miles Company to be included in this mortgage. The two mortgagor companies were owned or controlled by Finkelstein and Ruben. Included in the property covered by the mortgage were 18,773 shares of the Miles Company stock, which was owned by Finkelstein and Ruben. This, of course, did not amount to mortgaging the property of the Miles Company. There were, however, included in the mortgage, certain covenants by the mortgagor companies in reference to the Miles Company, and among them the following: "To cause the Miles Theater

Company to refrain from assigning, incumbering, or otherwise disposing of the leasehold, estates, and property belonging to it as aforesaid."

Whatever the legal effect of this covenant may be, yet the actions of Finkelstein and Ruben in causing the mortgagor companies which were owned or controlled by them to make this mortgage, and to include in it the Ruben and Finkelstein stock in the Miles Company, and also to enter into the covenant above quoted, were in my judgment of questionable propriety, if not a breach of trust, in view of the fact that Ruben and Finkelstein were directors of the Miles Company, and might be called upon at any time to vote upon the necessity or wisdom of the Miles Company placing a mortgage upon its own property.

I have not undertaken to discuss or pass upon all of the charges against the defendants made by the plaintiffs in their complaint. I have simply sought briefly to indicate the reasons why I have reached the conclusion that an accounting is necessary. The accounting must be general; but, while I have no inclination to limit its character, yet the taking of the same need not, and in my judgment ought not to, necessitate an analysis of all of the items of receipts and expenditures of the Miles Company while under the management of Finkelstein and Ruben, down to the present time, nor a complete construction of new books of account covering that period. Many of the matters to be investigated have already undergone more or less scrutiny. Tabulations have been made as to some of the matters involved. Whenever these tabulations, or books of account, for example, those constructed by Temple, Webb & Co., can be used to shorten the work of accounting, they should be so utilized, unless their accuracy is seriously questioned.

An interlocutory decree for an accounting in accordance with the foregoing views, and reserving the other issues in the case for future consideration, may be prepared by counsel for plaintiffs and submitted to counsel for defendants as to form before being presented for signature.

23 F.2d 357 (1927)

BACKUS et al.
v.
FINKELSTEIN et al.

District Court, D. Minnesota, Fourth Division.

November 19, 1927.

Harrison E. Fryberger, of Minneapolis, Minn., and Leslie H. Morse, of Mankato, Minn., for plaintiffs.

Doherty, Rumble, Bunn & Butler, of St. Paul, Minn., for defendants.

In Equity. Suit by H.N. Backus and others against M.L. Finkelstein and others. Decree in accordance with opinion.

CANT, District Judge.

Since about January 1, 1915, except as hereinafter set forth, the defendants Finkelstein and Ruben, through ownership or control of a majority of the stock, have been in complete control of the management of the Miles Theater Company, a South Dakota corporation, which during all of said time has been operating a moving picture theater at Minneapolis, Minn. This theater was first known as the Miles Theater, and later as the New Garrick. On April 28, 1918, the defendant Hamm, through contract with the other individual defendants above named, acquired an interest in said Miles Theater Company, and in other organizations and property controlled by said individual defendants. Except as otherwise appears from the context, the word "defendants," when used herein, shall be deemed to refer to the three individual defendants above named. In 1920, this suit was begun by certain stockholders in said Miles Theater Company, hereinafter referred to as the corporation, and by certain others who claimed that they had been stockholders therein and that they had been induced to sell their stock through the fraud and misrepresentation of defendants.

Since the institution of the suit, various other persons claiming to be in the same class last above referred to, have been allowed to intervene therein. All those who are plaintiffs or interveners claim that defendants have grossly violated their duties as managing agents of the corporation, and that, while defendants have profited greatly thereby, the corporation and the minority stockholders have suffered grievous losses in consequence thereof. For alleged wrongs against the corporation, and losses suffered thereby, plaintiffs and interveners pray a recovery on its behalf. On account of the

alleged fraud and misrepresentations whereby certain of the plaintiffs and interveners were induced to sell their stock, such parties pray that such sales be rescinded, and that they be restored to their respective positions as stockholders in said corporation.

1. The cause of action on behalf of the corporation was submitted to Hon. Wilbur F. Booth, while he was a judge of this court. 23 F.2d 531. Judge Booth determined conditionally that there should be a recovery on behalf of the corporation. Certain questions were definitely and finally passed upon by him and certain others were left for determination later on. By interlocutory decree the defendants were required to account with respect to various of the charges made against them on behalf of the corporation, and the matter was submitted to Special Master H.D. Irwin for the purpose of taking such accounting and reporting to the court his findings with reference thereto. Pursuant to such reference, evidence was taken at length on such accounting and the special master thereupon filed his report in such matter. Both plaintiffs and defendants filed exceptions to the report of the special master. Such exceptions, in part, have already been disposed of.

It is now ordered that the exceptions so filed, and each of them, be and they hereby are overruled, and that such report and findings be and they hereby are adopted and confirmed. This report, in large measure, affirms the claims of wrongdoing made on behalf of the corporation. The charges relating to the mortgage of $52,000 made by the corporation in 1914, and those relating to the mortgage of $250,000 made by certain other corporations, controlled by defendants Finkelstein and Ruben, in 1916, as well also as certain other matters of importance in the case, are not covered thereby. In view of the strict presumptions against defendants, which, as a matter of law, necessarily arose from the evidence, the report of the master was much more favorable to them than it might have been if the master had more fully indulged such presumptions. However, upon consideration of all thereof, the court has concluded to approve the report as made.

It is possible that defendants had no accurate knowledge or clear conception of their duties, or of what the law required of them as managing officers and owners of the majority of the stock in the corporation in question. It is at least charitable to take this view, and it may be according to the fact. It is not difficult to understand how in a somewhat vague and blind way they may have reasoned that such success as attended the corporation was largely due to their individual efforts, and therefore that they should reap the reward to the exclusion of all other persons. This may explain their course, but it fails entirely to justify or excuse. By their own conduct defendants, in large measure, have overwhelmed themselves, and they are not in a position to complain of the consequences which necessarily must follow. Neblett v. MacFarland, 92 U.S. 101, 105, 23 L. Ed. 471.

2. The rules applicable in such cases exact from those in control a high degree of diligence and good faith. The stockholders of a corporation, as such, cannot participate in shaping its policies or directing its activities from day to day. They are obliged to look to and rely upon the managing officers, who in theory of law, and as a matter of fact, represent and act for all the stockholders. Officers of a corporation, who through the ownership of a majority of the stock control its activities, occupy a fiduciary relation to

the minority stockholders, and at their peril must act in the strictest good faith in guarding the interests of the latter.

"Such a majority of the holders of stock owe to the minority the duty to exercise good faith, care, and diligence to make the property of the corporation in their charge produce the largest possible amount, to protect the interests of the holders of the minority of the stock, and to secure and deliver to them their just proportion of the income and of the proceeds of the property. Any sale of the corporate property to themselves, any disposition by them of the corporation or of its property, to deprive the minority holders of their just share of it, or to get gain for themselves at the expense of the holders of the minority of the stock, becomes a breach of duty and of trust which invokes plenary relief from a court of chancery." Jones v. Missouri-Edison Electric Co. (C.C.A.) 144 F. 765, 771. See, also, Wheeler v. Abilene National Bank Building Co. (C.C.A.) 159 F. 391, 394, 16 L.R.A. (N.S.) 892, 14 Ann. Cas. 917.

"Directors and officers of corporations occupy a position of trust and must act in the utmost good faith. They will not be allowed to deal with the corporate funds and property for their private gain. They have no right to deal with themselves and for the corporation at the same time, and they must account for the profits made by the use of the company's assets, and for moneys made by a breach of trust." McCourt v. Singers-Bigger (C.C.A.) 145 F. 103, 107 (7 Ann. Cas. 287), quoting from Ward v. Davidson, 89 Mo. 445, 458, 1 S.W. 846.

"That a director of a joint-stock corporation occupies one of those fiduciary relations where his dealings with the subject-matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts, and may be set aside on slight grounds, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and in others." Twin-Lick Oil Co. v. Marbury, 91 U.S. 587, 588, 589 (23 L. Ed. 328); Miner v. Ice Co., 93 Mich. 97, 109, 53 N.W. 218, 17 L.R.A. 412.

"The officers of a corporation are charged in the performance of their duties with certain obligations of trust and confidence to all the stockholders thereof without discrimination, to be performed with fidelity, and any intentional deviation or departure therefrom, to the substantial injury of any of the stockholders, constitutes willful mismanagement as a matter of law, for which a court of equity has jurisdiction to call them to account." Green v. National Advertising Amusement Co. et al., 137 Minn. 65, 162 N.W. 1056, L.R.A. 1917E, 784 (Syllabus — by the court).

"The law requires of the majority the utmost good faith in the control and management of the corporation as to the minority. It is of the essence of this trust that it shall be so managed as to produce for each stockholder the best possible return for his investment." Dill v. Johnston, 72 Okla. 149, 152, 179 P. 608, 610, quoting from Miner v. Ice Co., 93 Mich. 97, 53 N.W. 218, 17 L.R.A. 412. See, also, Jones v. Morrison, 31 Minn. 140, 148, 16 N.W. 854; Shearer v. Barnes, 118 Minn. 179, 136 N.W. 861.

3. The foregoing fundamental rules speak in unmistakable terms and are applicable throughout this case. It is clear that they go quite beyond any standards recognized by the defendants here. At first the defendants Finkelstein and Ruben, and later on those

two and the defendant Hamm, all stood in the relation of fiduciaries to the plaintiffs and interveners here. How distressingly far some or all of them wandered from the path of duty in such relation may be seen from an inspection of the master's report and from the further considerations herein.

4. Among the questions left for determination at this time is whether the conduct of defendants in relation to the corporation has been such that salaries should or should not be allowed them in connection with the services which they claim to have rendered. In this connection a long and imposing list of derelictions of duty are pressed upon the consideration of the court:

(a) The scrappy and sketchy and quite inadequate records which were kept of business transactions, whereby no stockholder, without great expense and much labor, could ascertain anything about the financial condition of the corporation.

(b) The loss or destruction of many important records, which a proper regard for the rights of others required should be preserved.

(c) The unfair allocation of the cost of films as between the New Garrick and other theaters.

(d) Charging the New Garrick with films which were never shown there.

(e) The unfair charges made against the New Garrick on account of joint expense incurred in the operation of that and other theaters.

(f) The continued and frequent abstracting of large sums of money from the treasury of the corporation by defendants for use in their private ventures. This went on without abatement for a considerable period of time after defendants were warned thereof by the allegations of the complaint herein.

(g) The attempted absorption by defendants of excessive amounts allowed to themselves as salaries. According to the evidence this continued long after and in defiance of the decision of Judge Booth, to the effect that in any event such salaries must be much reduced.

(h) Using the credit of the corporation to the extent of $52,000, through the execution and delivery by the corporation of a mortgage in that amount, given to secure a debt which was really that of defendants Finkelstein and Ruben, and which, in truth, was not a debt of the corporation at all.

(i) Causing to be inserted in a mortgage of $250,000, executed in 1916 by the New Palace Theater Company, of Minneapolis, and the New Princess Theater Company, of St. Paul, corporations controlled by defendants Finkelstein and Ruben, and which owned a majority of the stock of the Miles Theater Company, a clause whereby such corporations covenanted "to cause the Miles Theater Company to refrain from assigning, incumbering, or otherwise disposing of the leasehold estates and property belonging to it as aforesaid," by which clause defendants Finkelstein and Ruben for the purpose of advancing their private interests, virtually assumed to bind themselves as managing officers of the Miles Theater Company, during the life of the mortgage last referred to, to refrain from incumbering or selling the property of that corporation, no matter what its interests might require. This clause was, at least, a reckless disregard of

the interests of the corporation, and its tendency must have been to work a substantial damage thereto.

(j) The long course of alleged misconduct in connection with the purchase of stock from the minority stockholders, which will be referred to later in more detail.

These charges, and the wrongful design in connection with each, have all been fairly and fully established, in part by the evidence before Judge Booth and his decision, in part by the evidence before the special master and his findings, and in part by other evidence of a satisfactory character before the court at the final hearing.

Any person acting in a fiduciary capacity is entitled to compensation for his services, when he acts in good faith and for the best interests of his beneficiary in diligently guarding and advancing the interests of the latter. Any variation from this necessary requirement carries with it a forfeiture of all compensation which otherwise might be due. This rule applies to fiduciaries acting as managing officers of a corporation, as well as to all others. Munro v. Smith (C.C.A.) 259 F. 1, 21; McKinley v. Williams (C.C.A.) 74 F. 94; Wadsworth v. Adams, 138 U.S. 380, 11 S. Ct. 303, 34 L. Ed. 984; Eaton v. Robinson, 19 R.I. 146, 31 A. 1058, 32 A. 339, 29 L.R.A. 100; Murray v. Beard et al., 102 N.Y. 505, 508, 7 N.E. 553; Venie v. Harriet State Bank, 146 Minn. 142, 145, 178 N.W. 170.

Under the circumstances established here, the operation of these rules effectually prevents the allowance of any salaries to Finkelstein and Ruben on account of services rendered. The rules are designed to insure faithful service by the imposition of adequate penalties in case of a violation thereof. They are wise and wholesome, and under the circumstances here no court could do otherwise than apply and enforce them.

As to the defendant Hamm, the wrongs complained of continued without abatement, and some of them were appreciably increased, after he became interested. Upon his advent in the organization, Mr. Hamm, so far as the evidence discloses, was not relegated to a position of minor importance. He had twice as large an interest as any other individual therein. What was done was done more for him and in his behalf than for any one else. So far as can be learned from the evidence, his time and energies were not taken up with the mechanical part of the enterprise, nor with matters of detail, to such an extent that he was shut off from a view of the larger aspects of what was going on. He and those immediately associated with him were concerned with the policies and the management of the organization.

In connection with that management, if he was to draw the generous salary which he did, he should have been zealously guarding the interests of the corporation. If, without protest, he allowed frequent raids upon its treasury, and if he failed to see, or ignored, other and serious wrongs which were being perpetrated before his eyes, he is not in a position to ask compensation for services in protecting the interests of the corporation. Merely, in a general way, looking after his large investment in the enterprise, would entitle him to dividends, but would confer no right to any salary. The right, if any, to claim a salary would depend upon the rendering of substantial services to the corporation.

It is not a harsh, but a necessary, application of well-known rules which requires the court to hold that, under the circumstances here in hand, all salaries received by any of the defendants, with interest thereon, should be restored to the corporation, and should be paid to the person hereinafter specified, for its use.

5. The imposition of the debt and mortgage of $52,000 upon the corporation for the sole use and benefit of Finkelstein and Ruben was an unwarranted use of the corporate credit. It was the same, in effect, as if Finkelstein and Ruben had bought and paid for the majority of the stock in the corporation, and thereafter had used the credit of the corporation to raise the sum of $52,000 in money, and said money had been paid to them for use in their various private undertakings. In this case it stood in the place of and served for them as the equivalent of $52,000 in money, and gave them the possession and control of 8,922 4/51 shares of stock in the corporation.

In effect, the corporation paid for this stock. Under the circumstances the corporation is entitled to have canceled the stock so paid for and to recover all dividends received thereon, and defendants are entitled to credit for all sums paid by them or any of them in liquidation of such mortgage indebtedness and for interest thereon. Using the corporate credit in this way is essentially the same, in effect, as appropriating and using temporarily, or otherwise, the tangible property of the corporation.

The necessary effect of this mortgage was at once to depress the value of all the stock of the corporation. It had taken on a large indebtedness. Although the mortgage was executed before defendants Finkelstein and Ruben obtained full control of the corporation, it was all in the course of negotiations for obtaining such control, in which negotiations they had an active part, and was for their special benefit, although the negotiations were also for the benefit of Miles as well.

The way in which the property and rights of the corporation were made the convenient personal asset of defendants Finkelstein and Ruben is in part shown by the exhibits attached to the deposition of Daniel L. Bell, which was taken on July 21, 1922. In one of the exhibits, marked Exhibit A, and dated September 8, 1914, the said Bell, acting for Finkelstein and Ruben, assumed and agreed to pay the $52,000 mortgage against the property. This was the personal obligation of Finkelstein and Ruben, acting through Bell, to pay the debt of Miles, not the debt of the corporation. This was well known. Otherwise there would have been no occasion for the personal covenant in reference thereto. The fact, if such it was, that Miles wrongfully used the property of the corporation to further his personal ends does not excuse or make it less wrong for defendants Finkelstein and Ruben to do the same, nor does it affect their legal liability by reason thereof. Said defendants went further, however, and had the corporation itself undertake to pay the debt. In another exhibit, also marked A, attached to the same deposition, and dated November 23, 1924, the same thing is still more apparent, and the rights of all minority stockholders are quite disregarded.

The transaction comes within the rule announced in this circuit in the following language: "But a court of equity will hold such majority stockholder to the observance of the highest rectitude in dealing with the corporation, and, where the contract is unfair or unconscionable, where the consideration is inadequate, or where the contract is not for the best interests of the corporation, but subserves the selfish purpose of such

stockholder, it will set aside such contract at the instance of the corporation or its minority stockholders." Heim v. Jobes (C.C.A.) 14 F.2d 29, 32.

In all cases where a fiduciary for his own personal advantage uses the property of his cestui que trust, plenary relief may be granted. The hands of the court are not tied. Whatever relief may be appropriate to the particular case will be meted out to the parties. Setting aside the transaction and requiring that an accounting of profits be made is a common form of relief. Jones v. Missouri-Edison Electric Co. (C.C.A.) 144 F. 765, 771 et seq., 780; McKinley v. Williams (C.C.A.) 74 F. 94; McCourt v. Singers-Bigger (C.C.A.) 145 F. 103, 107, 7 Ann. Cas. 287; Maas v. Lonstorf (C.C.A.) 194 F. 577, 584; Pepper v. Addicks (C.C.) 153 F. 383, 405. So, where the credit of a corporation is used for the benefit of an individual managing agent thereof, all profits belong to the corporation. Goodhue v. Davis, 81 Minn. 210, 83 N.W. 531. See, also, Gross Iron Ore Co. v. Paulle, 132 Minn. 160, 166, 156 N.W. 268.

The fact that defendants have paid this mortgage indebtedness, or some part thereof, is not important, except as bearing upon the amount of credit which they should be allowed on account thereof. The appropriation and use of the corporate credit by Finkelstein and Ruben were fully consummated. Said defendants had acquired stock which presumably they could not otherwise have obtained. If later on, at their convenience, they made good the amount for which the corporate credit was used, they did that which might have been required of them at any time. This did not erase the original wrong, nor in the least affect the rights of the plaintiffs and interveners to cancel, so far as possible, the wrongful use of the corporate credit, and to compel defendants Finkelstein and Ruben to account for the gains which they had realized therefrom.

It is not a matter of allowing them to pay interest until the amount for which the credit was used should be paid, nor of charging said defendants with profits realized during that period. The application of such a rule would be wholly inadequate to serve as a deterrent from the commission of such unauthorized acts. The amount for which an accounting should be had would be the same whether the payment by defendants had been promptly made, or had been long delayed. The only office of the payment is not to end the period which should be covered by the accounting of profits, but as a credit to the wrongdoer on such accounting.

6. In this immediate connection it should be noted that the agreement between Bell on the one hand and Finkelstein and Ruben on the other, was that, in part, at least, the latter were to repay Bell on their indebtedness to him and for the stock they acquired through him, by turning over to Bell from time to time the amounts they should receive as salary from the Miles Theater Company. This was, in fact, done throughout a certain period. Since Finkelstein and Ruben were not entitled to any salaries, the turning over of such moneys to Bell was a wrongful appropriation of the corporate funds, and the stock so paid for, to the extent that payments were so made, should be canceled. In like manner, all other stock purchased by defendants, or any of them, through the use of corporate funds, excepting only such stock as, through rescission of the sale thereof, shall be restored to the original owners, should be canceled.

7. Although not so intended, or understood at the time, the objectionable clause hereinbefore referred to in the $250,000 mortgage, was of no binding force or effect. Seitz v. Michel, 148 Minn. 80, 85, 181 N.W. 102, 12 A.L.R. 1060; Van Slyke v. Andrews, 146 Minn. 316, 318, 178 N.W. 959, 12 A.L.R. 1068. It may properly be taken into account in considering the diligence and good faith, or the lack thereof, on the part of defendants Finkelstein and Ruben in guarding the interests of the corporation. Upon such point, as already indicated, it is of much significance, but beyond this it offers no basis for relief. This mortgage, and rights believed to flow therefrom, were matters upon which plaintiffs and interveners have quite largely relied. The court has been unable to agree with their claims in reference thereto.

8. For further consideration there are the claims on the part of the various plaintiffs and interveners that they have the right respectively to rescind the sales of stock in which they now claim an interest. Such claims are based on the alleged fraud, overreaching, and concealment on the part of defendants. Most of the charges of such alleged wrongdoing, being more particularly violations of the duties of the defendants to individual stockholders, rather than to the corporation as such, were not considered above in connection with wrongs which were more directly against the corporation itself.

In connection with such sales of stock made by plaintiffs and interveners there is a long list of serious charges made against the defendants: There was the prompt action on the part of the defendants, Finkelstein and Ruben, in beginning to acquire the stock; the continuance of such activities after defendant Hamm became associated with them; the fact that one or two men were specially and systematically active therein; that such men made various false and misleading statements to owners of stock; that through roundabout methods of dealing the names of the true purchasers, who were the defendants, were kept concealed; that payment of dividends by the corporation was suspended during the period when most of such stock was acquired; that many of the activities of defendants during such period tended directly to depress the value of the corporate stock; that letters, which were misleading and untrue, were sent to certain stockholders; that misleading financial statements were mailed to the stockholders; and that records were kept in such condition as to baffle any reasonable attempt at finding therefrom the financial status of the corporation.

Certain of these charges, if standing alone, might possibly be explained away in part, but, taking all together, one gives color to the others, and it is not reasonably possible to avoid the conclusion that all are well proven, and that they evidence a far-reaching scheme for acquiring the outstanding stock of the corporation in disregard of the rights of the minority stockholders, which rights defendants were bound under all the rules everywhere to guard and protect.

These charges are all of a grave character. The persistent failure to keep accurate books of account, and to preserve important records, alone places defendants in an almost hopeless position. In dealing with the property and rights of others, the necessity for keeping such accounts and of preserving such records in cases like this is unqualified, and is apparent to every one. The duty in that behalf is clear and beyond question. Pomeroy, Equity Jurisprudence, section 1063. Dunn v. Acme Auto Garage Co., 168 Wis. 128, 119 N.W. 297. Red Bud Realty Co. v. South, 96 Ark. 281, 299, 131

S.W. 340; Ithell v. Malone (Sup.) 154 N.Y.S. 275; Smith v. Moore (C.C.A.) 199 F. 689, 697; Gen. Stat. Minn. 1923, § 7470; Revised Code, S. Dak. 1919, §§ 8830-8832.

Failure to perform this duty, and to comply with this obvious requirement, properly entails consequences which follow almost automatically and as a necessary result therefrom. The almost necessary presumption is that the purpose of a failure in this respect has been to cover up or conceal what the records accurately kept would disclose. Bone v. Hayes, 154 Cal. 759, 766, 99 P. 172; Ill. Linen Co. v. Hough, 91 Ill. 63; White v. Rankin, 18 App. Div. 293, 294, 295, 46 N.Y.S. 228, affirmed 162 N.Y. 622, 57 N.E. 1128; Red Bud Realty Co. v. South, 96 Ark. 281, 299, 131 S.W. 340.

There is a compelling necessity for strictly enforcing the provisions of these rules and of this presumption. The failure to keep accurate accounts often means endless confusion from which there is no relief. "No court is equal to the examination and ascertainment of the truth of the claims in much the greater number of cases" where the fiduciary lends his efforts to confuse. King v. Remington, 36 Minn. 15, 25-26, 29 N.W. 352. Almost of necessity, in cases like this, the relief which can be granted will be quite inadequate. This is quite emphatically true in the case at bar. The fiduciary, in such cases, must be required at all hazards to keep clear and accurate records. If he does not, the burden, through the reasonably rigid application of presumptions, must fall on him, and not on other and innocent persons whom he has undertaken to serve, and whose property interests he in large measure controls. In all such cases, and except where satisfactory explanations are made, as, for example, where records are accidentally destroyed by fire, or otherwise, the courts are bound under the law to assume that the persons who fail to produce such records do not want to have them produced, and that it is to their advantage to conceal the truth.

9. It is reasonably clear that, as against the defendants Finkelstein and Ruben, except as herein otherwise specified, all plaintiffs and all interveners who are parties here are entitled to have the respective sales of their stock rescinded, and are entitled to be restored to their former status as stockholders in the corporation in question. Such rescission carries with it the right to recover from said defendants all moneys received as dividends on such stock, with interest from the time such dividends were paid, against which may be offset pro tanto the amounts paid to plaintiffs and interveners, or their predecessors in interest, for such stock, with interest thereon from the time such payments were made. The rights of plaintiffs and interveners in this respect, as against defendant Hamm, will be separately considered.

10. Some of the stock here in question was purchased after April 28, 1918. As to such stock, no matter whether the defendant Hamm actually participated personally in any of the alleged wrongdoing in reference thereto, or did not, his conduct in allowing the wrongs to go on, and in accepting the results thereof, amounted in law to a constant adoption and ratification by him, and he is necessarily bound thereby.

11. As to stock purchased prior to April 28, 1918, the situation of the defendant Hamm with reference thereto may be considered at the same time with his rights, and the rights of others against him, in connection with certain other features of the case. Such matters to be jointly considered are as follows:

(a) The accountability of the defendant Hamm with reference to stock wrongfully acquired from individual stockholders prior to April 28, 1918.

(b) His accountability with reference to stock purchased through the agency of the mortgage for $52,000, and that also which was paid for by salaries received by defendants Finkelstein and Ruben from the Miles Theater Company.

(c) His accountability for salaries wrongfully appropriated by Finkelstein and Ruben prior to April 28, 1918, and for matters covered by the report of the master, and occurring prior to said date.

As already indicated, at the time that the defendant Hamm purchased his interest in the copartnership of Finkelstein and Ruben, the two defendants last named had in their possession and under their control the physical property of the Miles Theater Company, a large number of shares of the stock in that corporation, and large sums of money which had been realized from the management and control of the corporate property, or from the purchase of the shares of stock therein, or, if they had not the money, they were liable to the corporation, and to the former stockholders on account thereof, and they had the property into which such money had been transformed.

Although in their possession, much of this property did not belong to Finkelstein and Ruben. Under the law they were bound to account for and turn over the same to the rightful owners thereof. They were holding such moneys and other property subject to the rightful demands of other people therefor. The obligations of said defendants were not in the nature of detached personal indebtedness unrelated to their connection with the corporation. Such obligations were intimately related to and the outgrowth of the connection of said defendants with the corporation, and were of such a nature that it was at all times impossible to know what their real interest in the corporation was, until the various claims and demands above referred to should be met and satisfied.

12. Under the foregoing conditions, defendant Hamm made his purchase. Were the circumstances of such purchase, or the character of the interest which he acquired, such that in some way he is protected from the demands now made against him and the other defendants? The answer should be in the negative on three grounds:

(a) As to wrongdoing prior to April 28, 1918, with respect to the matters here under consideration, the defendant Hamm may not have known the details thereof. Very likely he did not. As to what he actually knew, we need not stop to consider. Under the law he is equally bound by what he should have known. He acquired his interest and became active in the midst of outstanding mismanagement of the corporation. All this spoke out clearly at the time. It was perilous to purchase under such circumstances. It was much like walking into a fire. He was bound to inquire about practically everything. The state of the books and records alone required this and gave generous warning. The activities after he became interested dovetailed perfectly with those which had gone before. That the later activities were but continuations of the earlier was plainly evident. He either knew of the matters in question, or he allowed himself to remain oblivious to them all, permitting them to go on, and accepting the avails thereof. He must have known of the salaries taken by Finkelstein and Ruben prior thereto, and should have known that such taking was wrongful. He knew of the $52,000 mortgage, and without question knew of

the personal covenants to pay the same, which alone were amply sufficient to put him on inquiry as to the character of the obligation and for whose benefit it was entered into. His accountant, who represented him in a careful audit of such books and records as were available, must have had actual knowledge of many of the wrongs complained of, though both he and Mr. Hamm may not have appreciated the legal significance thereof. The interests of the defendant Hamm are therefore subject to the demands referred to, because in law he is deemed to have had notice of the infirmities in the title to that which he purchased.

(b) Apart from any question of notice, the defendant Hamm, in purchasing an interest in the copartnership of Finkelstein and Ruben, took that only which they could transfer to him. He stood in their shoes and took things as he found them. They could not transfer to him that which really belonged to someone else. He was not a bona fide purchaser. He acquired no particular stock certificates, and, if he had, they were not negotiable instruments. 14 C.J. 664, 665; Schumacher v. Greene Cananea Copper Co., 117 Minn. 124, 130, 134 N.W. 510, 38 L.R.A. (N.S.) 180, Ann. Cas. 1913C, 1115. He assumed to receive property to which his assignors had no valid title. He took his share in the assets subject to all valid claims against the same. He was not shielded against such claims by recording acts or otherwise. On these grounds alone the property which he assumed to purchase is subject to the demands referred to.

(c) Another ground of liability, from which there is no escape, lies in the fact that after April 28, 1918, defendant Hamm, with such notice and warning as he had, joined with the other individual defendants in carrying forward the wrongful practices which had long continued, and in that way identified himself with them as fully as if he had been a party thereto from the first. This, briefly, has already been referred to. Following this matter, and passing by many incidents which lead to the same conclusion, it is clear that, as events unfolded, a time came when Mr. Hamm could not longer, by any reasonable possibility, claim that he did not have notice of the wrongful acts of the other defendants, committed by them prior to said April 28, 1918. He certainly had such notice when this suit was brought, in which he was specifically notified thereof. He acquired it still more definitely when the decision of Judge Booth was filed herein.

Under such circumstances and with such knowledge as he then had, it was his duty to assist in compelling his codefendants to make restitution to the corporation. He did not do so. On the contrary, he denied and defended the wrongs which had been committed. These reached back to the year 1914. This attitude on the part of defendant Hamm was doubtless due to what is ordinarily the very commendable trait of loyalty to one's associates; but under the circumstances of this case it was another mistake of a serious character, and irrevocably bound said defendant to such earlier wrongs, made him a participant therein by adoption, and rendered him liable on account thereof.

13. There remain for consideration and determination certain questions of detail in connection with the relief which shall be granted herein:

(a) A recovery is allowed for considerable sums of money due the corporation and for other amounts due individual plaintiffs and interveners herein. The measure of relief to be granted must be such as is proper and suited to the circumstances of the case. It will not do to make a mockery of a proceeding where many litigants have been so long

and seriously contending for their rights. For obvious reasons, it may be highly improper to direct that the moneys here recovered on behalf of the corporation shall be paid into the treasury thereof. That might be paying the moneys back into the custody and control of those from whom the recovery is had. It might defeat effectually the purpose of the suit and be the beginning of another prolonged cycle of litigation. Unless conditions shall ensue which will materially change the situation, the distribution, so far as possible, should be directly to the individuals who will ultimately be entitled thereto. In cases where there is to be a direct distribution such as is proposed here, all who claim a right or interest in the funds must be given an opportunity, under proper conditions, to prove their claims.

For the present, therefore, provision should be made as follows: (1) For the appointment of a trustee or other similar officer, who, under the direction of the court, shall receive and disburse the funds which shall be recovered in the case; (2) that, upon proper notice, all who claim a right to share in the distribution of such funds as shall be collected be required to appear and make proof of their said claims. To the extent that such claimants have a right to prove that they are within the same class as plaintiffs and interveners here, they should have the same relief.

(b) A general view of the relief which may be granted in such cases as this may be had by consulting the following authorities. Many of them go much further than is contemplated here: Proctor v. Farrar (Mo.Sup.) 213 S.W. 469, 477; Miner v. Ice Co., 93 Mich. 97, 116-118, 53 N.W. 218, 17 L.R.A. 412; Hall v. Nieukirk, 12 Idaho 33, 85 P. 485, 118 Am. St. Rep. 188; Goodwin et al. v. Von Cotzhausen, 171 Wis. 351, 360, 177 N.W. 618; Eaton v. Robinson, 19 R.I. 146, 31 A. 1058, 32 A. 339, 29 L.R.A. 100; Dill v. Johnston (1919) 72 Okla. 149, 179 P. 608; Green v. National Advertising Amusement Co. et al., 137 Minn. 65, 162 N.W. 1056, L.R.A. 1917E, 784; Meeker v. Winthrop Iron Co. (C.C.) 17 F. 48.

The foregoing authorities have to do mainly with domestic corporations and with the exercise of the general equity powers of the court. It is now well settled that the relief to be granted may be substantially the same in the case of foreign corporations, where the property and officers of the corporation are within the jurisdiction of the court. Burnrite Coal Briquette Co. v. Riggs et al., 274 U.S. 208, 47 S. Ct. 578, 71 L. Ed. 100; Potter v. Victor Page Motors Corp. (D.C.) 300 F. 885; American Creosote Works v. Powell (C.C.A.) 298 F. 417; American Seating Co. v. Bullard (C.C.A.) 290 F. 896; Chicago Title Trust Co. v. Newman et al. (C.C.A.) 187 F. 573, 576; Corry v. Barre Granite Quarry Co., 91 Vt. 413, 101 A. 38; Tasler v. Peerless, 144 Minn. 150, 153, 174 N.W. 731; State v. North American, 106 La. 621, 31 So. 172, 87 Am. St. Rep. 309; Wait v. Kern, 157 Cal. 16, 106 P. 98. See, also, 12 R.C.L. 33; 14a C.J. 1337, 1338; Thomas v. Matthiessen, 232 U.S. 221, 34 S. Ct. 312, 58 L. Ed. 577.

(c) The appointment of a general receiver for the corporation will not be seriously considered at this time. Under all the well-considered authorities, many of which are cited above, this may be done. It is hoped and believed that the matter here involved may be adjusted without taking that step.

(d) The individual defendants above named are all equally liable and the defendant Twin City Amusement Trust Estate, which is a holding agency for such individual

defendants, is equally bound with them. The property of the corporation and that of the individual plaintiffs and interveners, and the gains therefrom, have been commingled and confused with property of the defendants. The sums found due should therefore be a charge and lien upon the property of the defendants held by the Twin City Amusement Trust Estate.

(e) Other relief discussed in the foregoing pages should be in accordance with the views there expressed.

14. Jurisdiction of this suit is expressly reserved for the purpose of making such further orders therein as may be appropriate or necessary to a full and final disposition of all matters necessarily connected therewith.

Let a decree be prepared by counsel for the prevailing parties in accordance with the foregoing opinion, and upon notice to opposing counsel let the same be presented to the court for examination and approval.

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Credit

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