

Corporations - Burden of Proof on Directors To Show Fairness of Transactions between Corporations with Common Directors - *Shlensky v. South Parkway Bldg. Corp.*, 19 Ill. 2d 268, 166 N.E.2d 793 (1960)

DePaul College of Law

Follow this and additional works at: <https://via.library.depaul.edu/law-review>

**Recommended Citation**

DePaul College of Law, *Corporations - Burden of Proof on Directors To Show Fairness of Transactions between Corporations with Common Directors - Shlensky v. South Parkway Bldg. Corp.*, 19 Ill. 2d 268, 166 N.E.2d 793 (1960), 10 DePaul L. Rev. 185 (1960)  
Available at: <https://via.library.depaul.edu/law-review/vol10/iss1/20>

This Case Notes is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Law Review by an authorized editor of Via Sapientiae. For more information, please contact [wsulliv6@depaul.edu](mailto:wsulliv6@depaul.edu), [c.mcclure@depaul.edu](mailto:c.mcclure@depaul.edu).

interest of the beneficiary is treated by the courts as personal property for all purposes.<sup>4</sup> This conversion of interest from realty to personalty is based on the doctrine of equitable conversion.<sup>5</sup>

Under the land trust the beneficiary is able to deal with real property as personal property,<sup>6</sup> but he cannot directly affect the legal title. Therefore, to sell he must act through the trustee. In the instant case, Harmon, the beneficiary, did not just attempt to assign or transfer his personal property interest—he tried to sell the land itself. In doing so, however, he learned the legal lesson of which all land trust beneficiaries might take note—namely, that while practically speaking he had complete control of the property, including the power to compel the trustee to convey, he could not directly convey the legal title himself. He had to act through the trustee, who had both legal and equitable title.

<sup>4</sup> 2 *Gordan v. Gordan*, 6 Ill. 2d 572, 129 N.E. 2d 706 (1955); *Dicus v. Scherer*, 277 Ill. 168, 115 N.E. 171 (1917).

<sup>5</sup> *Baker v. Commissioner*, 253 Mass. 130, 148 N.E. 593 (1925).

<sup>6</sup> For a discussion of the legal benefits of holding the property as personal property see CAPLAN, *THE LAW OF THE LAND TRUSTS* 12–18 (2d ed. 1958).

#### CORPORATIONS—BURDEN OF PROOF ON DIRECTORS TO SHOW FAIRNESS OF TRANSACTIONS BETWEEN CORPORATIONS WITH COMMON DIRECTORS

The plaintiffs, minority stockholders of a building corporation, brought suit on behalf of themselves and all the other stockholders to require the directors of the South Parkway Building Corporation to account to the corporation for damages allegedly suffered by various transactions between the South Parkway Building Corporation and the Union Amusement Company, the two corporations having interlocking directorates with both boards of directors dominated by one individual. The chancellor ordered defendants, as directors of the corporation, to give an accounting for the benefit of the stockholders. The appellate court reversed the chancellor's decree, but the Supreme Court of Illinois reversed the appellate court on the basis that the appellate court had erred in construing Illinois law as placing upon stockholders the burden of establishing actual fraud in transactions between corporations with interlocking directorates. *Shlensky v. South Parkway Bldg. Corp.*, 19 Ill. 2d 268, 166 N.E. 2d 793 (1960).

This case required a clarification of Illinois law respecting the obligation of corporate directorates. The plaintiff stockholders claimed, and the Supreme Court ultimately held, as above indicated, that the appellate

court<sup>1</sup> had erred in construing Illinois law as placing upon the stockholders the burden of establishing actual fraud in transactions between corporations with interlocking directorates. The defendants contended that the appellate court properly reversed the decree of the chancellor on the ground that his findings and order were based upon an erroneous concept of law, whereby transactions between corporations with some common directors were conclusively fraudulent. The Supreme Court of Illinois, in clarifying the law of the state, had to protect stockholders from exploitation by directors, and at the same time avoid undue restriction on corporate activity.<sup>2</sup>

Historically, the burden of proof in fraud, in the case of those not occupying a fiduciary relationship, is on the one asserting the fraud.<sup>3</sup> However, a fiduciary dealing with his beneficiaries is measured by a different standard. He cannot benefit by dealing with them to their disadvantage.<sup>4</sup> Corporate directors and the officers of a corporation have been recognized as being in a fiduciary relationship to the stockholders, in their corporate dealings. It is their duty to administer the corporate affairs for the common benefit of all the stockholders and to exercise their best care, skill and judgment in the management of the corporate business solely in the interest of the corporation.<sup>5</sup>

In early cases a director's role was identified with that of a trustee. Because he was to act solely in the interest of the corporation as *cestui que trust*, contracts between a director and his corporation were voidable at the option of the corporation.<sup>6</sup> The increasing complexity of corporate dealings showed the inadequacy of this doctrine and contracts were allowed to stand if the court found that they were fair,<sup>7</sup> and the burden of proving fairness fell on *the one who would maintain the contract*.<sup>8</sup>

The conflict in the instant case grew out of the decision of the Supreme Court of Illinois in *White v. Stevens*.<sup>9</sup> The court recognized that corpora-

<sup>1</sup> Shlensky v. South Parkway Bldg. Corp., 21 Ill. App. 2d 538, 159 N.E. 2d 31 (1959).

<sup>2</sup> For discussion of use of the fairness test see Note, 61 HARV. L. REV. 335 (1948).

<sup>3</sup> Racine Fuel Co. v. Rawlins, 377 Ill. 375, 36 N.E. 2d 710 (1941); Fidelity & Casualty Co. v. Genova, 90 F. 2d 874 (6th Cir. 1937); Barrett v. Shanks, 382 Ill. 434, 47 N.E. 2d 481 (1943).

<sup>4</sup> Farwell v. Pyle-National Elec. Headlight Co., 289 Ill. 157, 124 N.E. 449 (1919).

<sup>5</sup> Dixmoor Golf Club v. Evans, 325 Ill. 612, 156 N.E. 785 (1927); Winger v. Chicago City Bank & Trust Co., 394 Ill. 94, 67 N.E. 2d 265 (1946); Young v. Higbee Co., 324 U.S. 204 (1945).

<sup>6</sup> Burden v. Burden, 159 N.Y. 287, 54 N.E. 17 (1899).

<sup>7</sup> Twin-Lick Oil Co. v. Marbury, 91 U.S. 587 (1875).

<sup>8</sup> Pepper v. Litton, 308 U.S. 295 (1939).

<sup>9</sup> 326 Ill. 528, 158 N.E. 101 (1927).

tions having directors in common may contract with each other if the contracts were fair and reasonable, but emphasized that such transactions would be carefully scrutinized. In the course of the opinion the court mentioned, by way of dictum and without any citation of authority, that in contracts between corporations having one or more common directors "there is no presumption . . . that the contract is unfair or oppressive, but *the person attacking it* must prove its unfairness."<sup>10</sup> The defendants in the instant case relied upon this dictum of the *White* case, but it has not been followed by the Supreme Court of Illinois in any case since then.<sup>11</sup>

In the same year as the *White* decision, and in the same court, *Dixmoor Golf Club v. Evans*<sup>12</sup> was decided. The defendant in this case bought land for the purpose of selling it to the corporation, and did so sell it at an excess of the cost to him. The court held that since the board of directors was dominated by one member, and since it had purchased land from him for the corporation, although the corporation had use for the land, the profit derived from it by the director had to be returned to the corporation. The reasoning of the court was that the corporation had not been represented by disinterested directors, and a director, in his capacity as such, must always act for the benefit of the corporation. In effect therefore, by depriving the director of his profit the court allowed the corporation the benefit of the director's purchase of the land. The fact that the profit accrued to the director was sufficient for the return of the profit to the corporation. The burden of proving fairness of the transaction was not discussed. The *Dixmoor* case therefore, laid down a rule requiring much closer scrutiny of a single dominating director's corporate affairs than was indicated in the *White* case.

In *Winger v. Chicago City Bank & Trust Co.*<sup>13</sup> the court was confronted with a situation where the directors dealt with a company in which they had complete ownership. Disaffirmance of the contract was allowed. After citing *Dixmoor* the court said: "The fact that they [the directors] ostensibly deal with another corporation and transfer the property to it will not change the effect of the transaction. . . ."<sup>14</sup> The court went on to say that even if only one of the directors voting for the trans-

<sup>10</sup> *Id.* at 533, 158 N.E. at 103. (Emphasis added.) In this case the court held the contracts to be fair and reasonable, and the question of the burden of proof was not in issue. Therefore, the statement placing the burden of proof on the one attacking the contracts was, as mentioned in the text, merely dictum.

<sup>11</sup> The *White* case was cited by the appellate court in *Nagel v. Northern Ill. Gas Co.*, 12 Ill. App. 2d 413, 139 N.E. 2d 810 (1957). No authority other than the *White* case was cited in support of the proposition. *Nagel* is the only decision on the appellate level in accord with the *White* case.

<sup>12</sup> 325 Ill. 612, 156 N.E. 785 (1927).

<sup>13</sup> 394 Ill. 94, 67 N.E. 2d 265 (1946).

<sup>14</sup> *Id.* at 109, 67 N.E. 2d at 276.

action profited thereby, and his vote was necessary, the transaction would be tainted with the same illegality and fraud as though they were all interested.

In the instant case there was a situation of a controlling group common to both corporations—*i.e.*, interlocking directorates. A situation of this sort was resolved in the leading case of *Geddes v. Anaconda Copper Mining Co.*<sup>15</sup> The *Geddes* court stated the rule as follows:

The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon *those who would maintain them* to show their entire fairness and where a sale is involved, the full adequacy of the consideration. Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality, and we now add in the soundest business policy.<sup>16</sup>

It must be noted that the instant case adopted the rule of the *Geddes* case, and thus established it as the law in Illinois regarding the burden of proof in cases involving interlocking directorates. The wording of the *Geddes* rule is exactly *contra* to the dictum in the *White* case. However, the practical effect of the Illinois Court's adoption of *Geddes* is not to eradicate *White*. Since the *Geddes* rule is applied where a director or directors have excessive control over two corporations, the dictum in the *White* case might be adopted where a single director, not dominating in influence, is common to two corporations.

The Supreme Court of Illinois in deciding *Sblensky* according to the principles of the *Geddes* and *Winger* cases not only has followed the trend of protecting shareholders from exploitation, but also has provided corporations with freedom in their dealings on the assumption that honest dealings will be proven fair if challenged. This is entirely sensible and even necessary in view of the increasing complexity of corporate affairs and the growth of interlocking directorates.

<sup>15</sup> 254 U.S. 590 (1921).

<sup>16</sup> *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 599 (1921). (Emphasis added.)

### CRIMINAL LAW—POLICE OFFICER HELD GUILTY OF OFFICIAL MISCONDUCT FOR SOLICITING THEFT

Defendant, a police officer, was convicted of misconduct in office due to his solicitation of others to steal parking meter receipts. The appellate