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## A Proposed Reform in the Law Affecting Shareholders' Derivative Actions

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### III. Conclusion

The decisions of the courts in interpreting and applying General Municipal Law Section 50-e illustrated that in this area of the law, we are approaching the periphery of the realm of law wherein the technicality is preeminent. This is regrettable in the light of the fact that municipalities are projecting themselves into more and more fields<sup>54</sup> formerly peopled by individuals and private corporations, whose responsibility to respond in tort is not so protected by the encrustation of technical requirements which are utilized by municipalities to frustrate substantive rights. It is true that the treasuries of municipalities must be protected against the importunities of fraudulent and sleeping claimants, yet this end may be attained without concomitantly frustrating the rights of honest, but humanly remiss, claimants. The original draft of the Judicial Council proffered a system by which that end could be attained and rights preserved. A necessary preliminary to the adoption of such a system is the institution, by the bench and the bar, of an educational campaign dedicated to the appraisal of the public and the Legislature of the inadequacies of the present statute. In the interim, we can hope for the adoption of the renewed recommendations of the Judicial Council, which would serve to some extent to alleviate the inequities still pervading this area of the law.<sup>55</sup>

PATRICK FALVEY.

A PROPOSED REFORM IN THE LAW AFFECTING SHAREHOLDERS' DERIVATIVE ACTIONS.—That New York legislation has become a model for many states is due to a great extent to the salutary efforts of its Law Revision Commission and Judicial Council which study

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<sup>54</sup> Note that in the case of an adult claimant, N. Y. GEN. MUNIC. LAW § 50-e does not apply in respect to a claim against the New York Housing Authority, *Matter of Kaufman v. New York Housing Authority*, 188 Misc. 877, 67 N. Y. S. 2d 174 (Sup. Ct. 1946), *aff'd*, 272 App. Div. 829, 70 N. Y. S. 2d 329 (2d Dep't 1947). However, in the case of an infant claimant, subdivision six thereof has been implemented to amend the unverified notice of claim served upon the New York Housing Authority, *Matter of Belardinelli v. New York Housing Authority*, 187 Misc. 920, 67 N. Y. S. 2d 94 (Sup. Ct. 1946). It is not necessary to expatiate upon the statement that the number of claims against the City of New York based on tort will increase appreciably due to the city's absorption of the subway system.

<sup>55</sup> 15 REP. JUDICIAL COUNCIL 76 (1949). Note that these renewed recommendations are a reiteration of those made in 12 REP. JUDICIAL COUNCIL 59-60 (1946) which pertained only to extending the period to ninety days and to the removal of the prerequisite to relief under subdivision six, that the application be made before trial, etc. It is hoped that the scope of the recommendations will be enlarged in the future to include proposals for the revision of the present statute by which it would approach the liberality of the original draft proffered by the Judicial Council.

proposed statutory enactments and offer recommendations. Inquiry is in order, therefore, when an amendment which in effect precludes the prosecution of the shareholders' derivative action, is passed by the legislature against these recommendations.

In approving the enactment of Section 61-b<sup>1</sup> of the N. Y. General Corporation Law, Governor Thomas E. Dewey in his memorandum, made the following comment upon stockholders' derivative actions: "In recent years a veritable racket of baseless lawsuits accompanied by many unethical practices has grown up in this field. Worse yet, many suits that were well based have been brought, not in the interest of the corporation or its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or its stockholders. Secret settlements—really pay-offs for silence—have been the subjects of common suspicion."<sup>2</sup>

To preclude extortionate practices in the form of derivative suits, Section 61-b requires the plaintiffs in such a suit to give security for expenses which will be incurred by the corporation in defending such an action unless the plaintiffs possess shares of stock exceeding in value the sum of fifty thousand dollars or own at least five per cent of the outstanding capital stock.

This article proposes to illustrate: (1) The present law in New York in respect to derivative suits; (2) California's attempt to regulate the derivative suit; (3) the unsolved problem and (4) a recommendation therefor.

### *New York View*

The derivative suit is the shareholder's only remedy for breach of trust on the part of those entrusted with the management and direction of the corporation.<sup>3</sup> The shareholder sues in the right of

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<sup>1</sup> The full text of the statute is as follows: "In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five per cent of the outstanding shares of any class of such corporations' stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action by the other parties defendant in connection therewith for which it may become subject pursuant to section sixty-four of this chapter, to which the corporation shall have recourse in such amounts as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

<sup>2</sup> *Lapchak v. Baker*, 298 N. Y. 89, 94, 80 N. E. 2d 751, 753 (1948), citing Public Papers of Governor Dewey, p. 255 (1944).

<sup>3</sup> This derivative suit must be distinguished from the shareholders' representative suit which may be brought by one or more shareholders as representatives of a class where the members of the class are too numerous to be

the corporation to whom the claim arising from official misconduct belongs<sup>4</sup> and, consequently the period of time within which the shareholder may sue is measured by the limitation which would apply had the corporation itself instituted suit.<sup>5</sup> As a condition precedent to the bringing of the action, the shareholder must show not only a wrong done to the corporation but also a refusal by the corporation to redress the wrong.<sup>6</sup> But if the directors at the time of commencement of suit are the same individuals who have committed the wrongs,<sup>7</sup> or if the wrongs complained of have been ratified by the corporation,<sup>8</sup> no demand is necessary.

The shareholder who sues in the right of the corporation joins the corporation as party defendant.<sup>9</sup> In New York it has been held that the complaining stockholder has complete dominion over his derivative action, and may continue, compromise, abandon or discontinue it at his pleasure.<sup>10</sup> There is no doubt that a final judgment in a derivative suit, even if entered by consent,<sup>11</sup> is *res adjudicata* and bars other shareholders from pursuing the same corporate cause of action.<sup>12</sup> However, it would seem that settlement or compromise even if made under judicial supervision does not bind shareholders not joined in the suit so as to preclude them from later asserting the same cause of action.<sup>13</sup>

named and joined as actual parties plaintiff. The representative suit is brought to enforce an individual right of each member of the class whereas the derivative suit is brought by the shareholder to enforce a right of the corporate entity. See STEVENS, CORPORATIONS § 167 (2d ed. 1949).

<sup>4</sup> *Robertson v. Schoonmaker*, 158 Misc. 627, 285 N. Y. Supp. 204 (Sup. Ct. 1935).

<sup>5</sup> *Potter v. Walker*, 159 Misc. 339, 287 N. Y. Supp. 806 (Sup. Ct. 1936).

<sup>6</sup> *Hornstein v. Paramount Pictures*, 37 N. Y. S. 2d 404 (1942), *aff'd*, 266 App. Div. 659, 41 N. Y. S. 2d 210 (1st Dep't 1943), *appeal denied*, 266 App. Div. 828, 43 N. Y. S. 2d 751 (1st Dep't 1943), *aff'd*, 292 N. Y. 468, 55 N. E. 2d 740 (1943).

<sup>7</sup> *McQuade v. Cook*, 193 Misc. 435, 84 N. Y. S. 2d 495 (Sup. Ct. 1948); *Guttman v. Conda Co.*, 249 App. Div. 621, 290 N. Y. Supp. 874 (2d Dep't 1936).

<sup>8</sup> *McCrea v. Robertson*, 192 N. Y. 150, 84 N. E. 960 (1908); *Kavanaugh v. Commonwealth Trust Co.*, 181 N. Y. 121, 73 N. E. 562 (1905).

<sup>9</sup> *Security Trust Co. v. Pritchard*, 201 App. Div. 142, 194 N. Y. Supp. 486 (4th Dep't 1922).

<sup>10</sup> *Manufacturer's Mut. Fire Ins. Co. v. Hopson*, 176 Misc. 220, 25 N. Y. S. 2d 502 (Sup. Ct. 1940), *aff'd*, 288 N. Y. 668, 43 N. E. 2d 71 (1942) (a stipulation of discontinuance is effectual to terminate action); *Hershfeld v. Fitzgerald*, 157 N. Y. 166, 51 N. E. 997 (1898); *Brinckerhoff v. Bostwick*, 99 N. Y. 185, 1 N. E. 663 (1885). See 4 COOK, CORPORATIONS 3286 (8th ed. 1923).

<sup>11</sup> *Gerith Realty Co. v. Normandie Natural Sec. Corp.*, 154 Misc. 615, 276 N. Y. Supp. 655 (Sup. Ct. 1933), *aff'd*, 241 App. Div. 717, 269 N. Y. Supp. 1007 (1st Dep't 1934), *aff'd*, 266 N. Y. 525, 195 N. E. 183 (1935).

<sup>12</sup> *Brinckerhoff v. Bostwick*, *Manufacturer's Mut. Fire Ins. Co. v. Hopson*, *supra* note 10.

<sup>13</sup> *Clarke v. Greenberg*, 296 N. Y. 146, 71 N. E. 2d 443 (1947).

Section 61-b was enacted to preclude the mischief of strike suits<sup>14</sup> by requiring security for expenses if the plaintiffs do not meet certain minimum requirements. Although in any action brought in the right of a foreign or domestic corporation it must be made to appear that the plaintiff was a shareholder at the time the transaction of which he complains occurred,<sup>15</sup> a shareholder under Section 61-b need not have the five per cent or fifty thousand dollars of stock minimums at the time the wrongs complained of took place.<sup>16</sup> Thus, where a shareholder acquired by transfer subsequent to the commencement of the action a sufficient number of shares to form the required five per cent, the section was complied with.<sup>17</sup> A shareholder maintaining a suit in the right of the corporation is entitled to an order, in the discretion of the court, permitting him to examine the stock book for the purpose of soliciting additional shareholders to join as party plaintiffs so as to vacate an order for security.<sup>18</sup>

The section applies by its terms "to any suit" brought by a shareholder in the right of the corporation and so includes any cause of action whatsoever accruing to the corporation which the latter has failed or neglected to pursue;<sup>19</sup> but does not apply to a representative action, that is, one wherein the right of action accrues not to the corporation as such, but to shareholders in their individual capacity against either the corporation or its officers.<sup>20</sup>

In the case of *Cohen v. Beneficial Industrial Loan Corporation*,<sup>21</sup> the United States Supreme Court upheld the constitutionality of a similar New Jersey statute, which by its terms was retroactive,<sup>22</sup> and held that this section was not a violation of either the "due process" or "equal protection clauses" and was not unconstitutional as class

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<sup>14</sup> "A strike suit has been defined as 'an action brought purely for its nuisance value, with the purpose of obtaining a settlement for the complainant's sole benefit—the amount of the proposed settlement being far greater than any possible injury suffered by the complainant.'" BALLANTINE, CORPORATIONS 356 (rev. ed. 1946). See *Isensee v. Long Island Motion Picture Co., Inc.*, 184 Misc. 625, 54 N. Y. S. 2d 556 (Sup. Ct. 1945).

<sup>15</sup> N. Y. GEN. CORP. LAW § 61.

<sup>16</sup> *Noel Associates v. Merrill*, 184 Misc. 646, 53 N. Y. S. 2d 143 (Sup. Ct. 1944).

<sup>17</sup> *Purdy v. Humphrey*, 187 Misc. 40, 60 N. Y. S. 2d 535 (Sup. Ct. 1946). See *Weinstein v. Behn*, 68 N. Y. S. 2d 199 (Sup. Ct. 1947), *aff'd*, 272 App. Div. 1045, 75 N. Y. S. 2d 284 (1st Dep't 1947), where the value of stock was determined at the date of intervention rather than at the date of commencement of the action. The value of the stock had declined between those two dates.

<sup>18</sup> *Baker v. Macfadden Publications*, 300 N. Y. 325, 90 N. E. 2d 876 (1950), *reversing* 270 App. Div. 440, 59 N. Y. S. 2d 841 (1st Dep't 1946).

<sup>19</sup> *Schwartz v. Kahn*, 183 Misc. 252, 50 N. Y. S. 2d 931 (Sup. Ct. 1944).

<sup>20</sup> *Lennan v. Blakely*, 80 N. Y. S. 2d 288 (Sup. Ct. 1948).

<sup>21</sup> 337 U. S. 541 (1949).

<sup>22</sup> Section 61-b has been held not retroactive in *Shielcrawt v. Moffett*, 294 N. Y. 180, 190, 61 N. E. 2d 435, 439 (1945), 31 VA. L. REV. 946 (1945). See also *Mahler v. Trico Products Corp.*, 271 App. Div. 179, 63 N. Y. S. 2d 168 (4th Dep't 1946), *aff'd*, 296 N. Y. 902, 72 N. E. 2d 622 (1947).

legislation.<sup>23</sup> This decision also determined that the statute's application in the federal courts was mandatory in all diversity of citizenship cases under the holding in *Erie v. Tompkins*,<sup>24</sup> as being a substantive enactment creating a right in the corporation which it had not previously enjoyed,<sup>25</sup> rather than a mode of procedure.

### *California View*

In an effort to curtail the alleged abuses of the shareholder's derivative suit the legislature of the state of California has added Section 834 to its Corporation Code.<sup>26</sup> This statute, while requiring security for expenses, established a different standard from New York in determining when a shareholder shall be required to furnish security. Those states<sup>27</sup> which follow the example set by New York all require the plaintiff shareholder to be the owner of a specified interest in the corporation. Section 834 does not discriminate against a litigant merely because of his pecuniary status in society. It simply demands a preliminary investigation in order to ascertain whether, (1) there is a reasonable probability that the prosecution of the action will benefit the corporation or its security holders or (2) that the moving defendants did not participate in the alleged wrongs against the corporation. If these motions are decided in favor of the plaintiffs and against the moving defendants, a judicial determination is then made that the action has been brought in good faith and that it is not a "strike suit." The action is to be stayed until these motions have been decided. If the plaintiff fails to defeat either motion, security will be required. In New York the corporate defendant is the only one who may move for security and may do so at any time prior to judgment,<sup>28</sup> while in California the motion must be made and determined during a preliminary hearing<sup>29</sup> and may be made by any party defendant. In the event that more than one

<sup>23</sup> *Isensee v. Long Island Motion Picture Co., Inc.*, 184 Misc. 625, 54 N. Y. S. 2d 556 (Sup. Ct. 1945) (not unconstitutional as class legislation). See Note, 23 ST. JOHN'S L. REV. 296, 299 (1949).

<sup>24</sup> 304 U. S. 64 (1938).

<sup>25</sup> *Lapchak v. Baker*, 298 N. Y. 89, 80 N. E. 2d 751 (1948).

<sup>26</sup> CAL. STAT. c. 419 (1949). For analysis of this section see Ballantine, *Abuses of Shareholders Derivative Suits: How Far Is California's New "Security for Expenses" Act Sound Regulation?* 37 CAL. L. REV. 399 (1949); Hornstein, *The Future of Corporate Control*, 63 HARV. L. REV. 476 (1950).

<sup>27</sup> New Jersey, N. J. STAT. ANN. § 14:3-15 (Cum. Supp. 1947); Pennsylvania, PA. STAT. ANN. tit. 12, § 1322 (Purdon, Cum. Supp. 1946); Maryland, MD. ANN. CODE GEN. LAWS Art. 16, § 195 (Supp. 1947); Wisconsin, WIS. STAT. § 180.13(3) (1945).

<sup>28</sup> *Tichner v. Andrews*, 193 Misc. 1050, 85 N. Y. S. 2d 760 (Sup. Ct. 1949).

<sup>29</sup> The motion must be made within thirty days after service of summons, but the court may extend the period for sixty days more on good cause shown. In New York under GEN. CORP. LAW § 61-b express provision is made for increase of security at any time prior to judgment, while in California there is no such provision for increase.

party defendant makes the motion for security, only those who succeed will be entitled to bond. Thus the plaintiff may be led to discontinue the action as to certain defendants for which he will be required to furnish security for costs and to proceed only against those parties as to whom no improbability of benefit from the suit has been shown.

By way of comparison, it should be noted that Section 834 is not as stringent as Section 61-b; yet it is open to severe criticism. The plaintiff must make a demand on the corporation to bring the suit, and the plaintiff must submit to the defendant a true copy of the complaint which he proposes to file and in addition thereto, must have his proof in final form at the hearing on the motion. This procedure precludes the shareholder from the benefits that would be derived through a pre-trial examination. Hence, the plaintiff is not given the opportunity to examine corporate books and records which are essential to sustaining the allegations of his complaint. When a complaint is drafted in these actions, a plaintiff generally has sufficient evidence with which to piece together a cause of action; but there are many details that can only be filled in by an inspection of the corporate books and records. Without this evidence the plaintiff-shareholder is placed at a severe handicap at the hearing on the motion and the odds are balanced in favor of the defendant's being successful because of superior and actual knowledge of the internal functioning of the corporation. It cannot be denied that shareholders are frequently intentionally kept in ignorance concerning the manipulations of corporate affairs specifically for the purpose of preventing them from acquiring knowledge and information that could form the basis of a derivative or representative action. Although the shareholder is theoretically an owner of the corporation, he is considered an officious intermeddler if he makes inquiries seeking more information than is given through financial statements. By means of the preliminary hearing on the motion, the defendant learns the extent of the plaintiff's evidence and is given the opportunity to defeat him then and there through the imposition of a contingent liability should the plaintiff fail to establish his cause at the trial. If the defendant's motion for security is denied, the defendant is given a second opportunity of contesting substantially the same evidence at the trial.

It has been estimated that from seven to forty-five per cent of the outstanding stock of listed corporations is kept in a street name.<sup>30</sup> Since only registered shareholders may maintain the action under Section 834, all equitable owners are thereby deprived of this valuable right.<sup>31</sup>

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<sup>30</sup> P-H CORP. REP. BULL. No. 9 at 7 (Mar. 23, 1949); Hornstein, *The Future of Corporate Control*, 63 HARV. L. REV. 476, 480 (1950).

<sup>31</sup> See *Rosenthal v. Burry Biscuit Corp.*, — Del. —, 60 A. 2d 106 (1948) (equitable owner entitled to maintain derivative suit). See also Recent Case, 23 TEMP. L. Q. 82 (1949).

The California statute goes beyond the New York section by permitting any stranger defendant to move for security. The only liability which the New York act imposes is for the expenses that the corporation itself would incur under Section 64 of the New York General Corporation Law. The California statute gives a right of indemnification to any defendant even though the corporation would not be liable to reimburse him since he was not a director, officer or employee.

Although the order granting or refusing security is a final order or adjudication, there is no provision made for an appeal from that order.<sup>32</sup>

California's attempt to control the so-called "strike suit" is merely a procedural deviation from the method employed by New York. Both statutes are subject to the same criticism: namely, that they tend to defeat and discourage the bringing of legitimate actions. This, in effect, increases the opportunities of irresponsible corporate officials to plunder the assets of the corporation and to take for themselves business opportunities which rightfully belong to the corporation itself, thereby, indirectly depriving the shareholders of their proprietary rights. In the absence of such statutes, the threat of a derivative suit acts to deter those who might be inclined to "feather their own nests" at the expense of the corporation. It is thought that such leeway and license should not be sanctioned by statute. If an evil exists in the absence of control over derivative suits, it should not be replaced by another evil. Remedial legislation should strike a balance by which neither party to a controversy is unjustly penalized. While the law presumes that all men will do good rather than evil, is it wise to build a wall of protection around those fiduciaries who would take advantage of such protection and reap for their personal benefit rather than for the welfare of their trust?

In the case of *Cohen v. Beneficial Industrial Loan Corporation*, the court passed merely upon the power and not the wisdom of a state to enact a security for reasonable expenses statute. This raises another question and that is, "Is it sound policy for a state to create a liability where none has existed before so as to bar a person from the only remedy he may invoke to prevent corporate mismanagement?" In the absence of a security for expenses statute the plaintiff in a derivative action would only be liable for the court costs of the defendant, as a matter of right if the action was at law, and as a matter of discretion if the suit was in equity. In no other type of litigation is an unsuccessful party bound to pay the expenses, including attorney's fees, of the successful litigant. Why should one class of suitors be singled out for this penalty? The essential difference between California and New York is as to this aspect of the

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<sup>32</sup> Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 37 CAL. L. REV. 399, 416 (1944).



statute that in California all unsuccessful parties who have not defeated the plaintiff's motion are penalized while in New York all unsuccessful parties who own less than fifty thousand dollars worth of outstanding stock or own less than five per cent are penalized. It is submitted that this is the only substantial difference between the two statutes and that neither one is an adequate solution to the problem.

### *The Unsolved Problem*

Prior to the enactment of Section 61-b the shareholder's derivative suit was universally reviled and deplored.<sup>33</sup> It is conceded that prior to the passage of this corrective legislation, corporations had been subject to countless, baseless lawsuits brought for purposes of extortion and nuisance. Justification, however, cannot be found for legislation which virtually excludes small shareholders from maintaining suits placing upon them an unnecessary evil in the form of a liability predicated upon financial status. Such statutes also enhance the opportunities of majority shareholders fraudulently to oust minority members from active participation in management and deprive them of justly due emoluments.

Inasmuch as "In a publicly owned corporation, it is notorious that rarely will only one person—not already in the management—own as much as one per cent of the outstanding stock,"<sup>34</sup> in practice, the statute creates an absolute bar, unless shareholders owning five per cent of the outstanding stock could be collectively aroused to join in the action. Realistically this is not possible because the expenses involved in so joining other shareholders would be tremendous, and the manifest indifference of stockholders in large publicly owned corporations would bar collective organization. In this respect, it would be well to note that the statute of limitations continues to run while the shareholder conducts this campaign and so may ultimately bar his action, if the time necessary to arouse other shareholders to join in bringing the action is prolonged through the above mentioned detriments.

Under the statute, once an order for security has been made it may be vacated by subsequent joinder of party plaintiffs.<sup>35</sup> However, it must be emphasized that although a shareholder may own an

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<sup>33</sup> For discussions of abuse incident to derivative actions prior to remedial legislation, see 1942 LEG. DOC. NO. 65(J), 1942 REPORT, N. Y. LAW REVISION COMMISSION 481; 34 COL. L. REV. 784 (1939). See also Wood, *Survey*, 82 CHAMBER OF COMMERCE OF STATE OF N. Y. (1944).

<sup>34</sup> Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 COL. L. REV. 1 (1947). T.N.E.C. Rep't, Survey of Stockholding of 1710 Corporations with Securities listed on a National Securities Exchange, Monograph 30 (1941) shows that 96% of all stockholdings analyzed had a value of less than \$10,000.

<sup>35</sup> *Baker v. Macfadden Publications*, 300 N. Y. 325, 90 N. E. 2d 876, reversing 270 App. Div. 440, 59 N. Y. S. 2d 841 (1st Dep't 1946).

amount of the entire outstanding stock of a corporation sufficient to comply with the statute, he may be required to post security if he does not possess the minimal requirements of five per cent as to any one class of the outstanding capital.<sup>36</sup> It is apparent, then, that the statute interferes with the antecedent right of small shareholder to maintain derivative actions, and gives to corporations rights which they had not previously enjoyed.<sup>37</sup>

### *Recommendation*

Obviously, some method must be developed to remedy the wrongs incident to derivative suits, existing prior to and subsequent to the passage of Section 61-b. The short range approach to this problem has produced inequitable and innumerable hardships. Prior to any remedial legislation, many unfounded derivative suits were instituted against corporations merely for the purposes of extortion and of inducing private settlements. If these actions were permitted to proceed to final judgment, the plaintiffs would be unsuccessful and yet the corporation would then be burdened with unnecessary counsel fees. In order to escape these costs, and many times to prevent publication of wrongs which have been committed, corporations have compromised, and made settlements which resulted in pecuniary benefit not to the corporation, but to the plaintiff shareholder. Section 61-b, while enacted with a view of preventing the institution of unfounded claims has, in effect, impaired the prosecution of many well founded claims, and this because the large shareholders are usually in control of the management of the corporation.

Our problem then is to (1) prevent private extortionate settlements and (2) allow the prosecution of actions by stockholders, without requiring them to deposit security, whenever they establish a reasonable possibility of success.

In 1940, Justice Shientag, in *Manufacturers Mutual Fire Insurance Company of Rhode Island v. Hopson*,<sup>38</sup> suggested the adoption of a court rule similar to Federal Rule 23(c),<sup>39</sup> which suggestion was considered, expanded and advocated by the New York Law Revision Commission in 1942.<sup>40</sup> A statute substantially embodying this rule was recommended by this commission, but was defeated because of the persistent opposition of large publicly owned corporations.<sup>41</sup>

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<sup>36</sup> The terminology of the statute seems to indicate this conclusion, but no case directly in point has as yet been so decided. See note 35 *supra* and *Noel Associates v. Merrill*, 184 Misc. 646, 53 N. Y. S. 2d 143 (Sup. Ct. 1944).

<sup>37</sup> *Shielcrawt v. Moffett*, 294 N. Y. 180, 190, 61 N. E. 2d 435, 439 (1945).

<sup>38</sup> 176 Misc. 220, 25 N. Y. S. 2d 502 (Sup. Ct. 1940).

<sup>39</sup> FED. R. CIV. P. 23(c).

<sup>40</sup> 1942 LEG. DOC. NO. 65(J), 1942 REPORT, N. Y. LAW REVISION COMMISSION 471.

<sup>41</sup> See Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 32 CAL. L. REV. 123 (1944).

Under Rule 23(c) a shareholder's suit once started may not be discontinued, dismissed by consent or compromised without court approval. The court must order notice of dismissal of compromise to be given to all shareholders. Any payments made to the plaintiff to induce settlement or compromise belong to the corporation which has a right of action to recover the same.<sup>42</sup> This statute is easily evaded since the plaintiff can abandon the suit at will, perhaps after the shares of the plaintiff have been purchased by the corporation at a handsome figure.<sup>43</sup>

It is recommended that Section 61-b be repealed (thus relieving the plaintiff from any security for expenses), and in its stead Rule 23(c) be substituted, but in such a form as to bar its facile evasion by means of abandonment.

This can be done by providing that the summons in the action be labeled "shareholders' derivative action"<sup>44</sup> and that the clerk of the court shall, if the calendar is not answered, notify the attorney general or such other state official as may be designated. The statute shall then order the attorney general or such other state official as has been designated, to investigate the circumstances surrounding the abandonment, and if it be found that there has been a collusive settlement, criminal proceedings shall then be prosecuted to impose a fine equivalent to the benefits received under the settlement. Each party to the settlement, excluding the corporation, shall be severally liable to the state for a penalty equivalent to the monies received under the settlement and the statute shall in no way affect the corporation's right to obtain all the benefits of that private settlement.<sup>45</sup>

A duty might also be imposed on every corporation doing business in this state to serve notice on the attorney general, or other designated state official, that it has been served with summons in a derivative suit and also a duty to notify that public officer of any discontinuance of such suit by a means other than one judicially supervised. If the corporation fails to so notify the attorney general, it shall be liable to the state for the precise penal provision heretofore discussed. However the legislature may cope with the derivative suit problem, it is submitted that Section 61-b is not the adequate remedy. Evident is the law; manifest the evil, and incomplete the remedy. The ultimate decision must lie in the wisdom of the legislature.

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<sup>42</sup> *Young v. Higbee*, 324 U. S. 204 (1945); see Hornstein, *op. cit.* note 34, 47 *COL. L. REV.* 1, 14 (1947).

<sup>43</sup> See *Eisenlahr v. Kalodner*, 145 F. 2d 316, 319 (C. C. A. 3d 1944).

<sup>44</sup> This procedure has been adopted in actions for divorce, separation and annulment, N. Y. CIV. PRAC. ACT § 1167; N. Y. CIV. PRAC. R. 47.

<sup>45</sup> *Clarke v. Greenberg*, 296 N. Y. 146, 71 N. E. 2d 443 (1947).