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Federal Jurisdiction--Stockholder's Derivative Action--Held Antagonism Exists When Management Is Aligned Against Stockholder (Smith v. Sperling, 354 U.S. 91 (1957))

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court categorically to answer any question propounded by a jury constitutes error." [20]

In the *La Marca* case, the Court distinguished the *Gonzalez* and *Gezzo* cases on their facts [21] and quoted from the *Cooke* majority opinion.[22] The psychiatrist for the defense had testified to the effect that defendant did not know his act was wrong until the day following its commission. Since, however, kidnapping is a continuing crime, the jury could find that defendant had persisted in the act after realizing its wrongful nature and had therefore become criminally responsible. The jury's question—"If one should belive [sic] that the defendent [sic] was insane part of the time during the commission of the crime must we find in favor of the defendent [sic]" [23]—could only be answered in the negative. Thus, reasoned the Court, no harmful inference could have been drawn by the jury: if a negative answer were assumed, that would have been correct; if positive, that would have incorrectly benefited the defendant. A clear rule thus emerges, distinct from any consideration of Section 427; only an implication arising from a judge's refusal to respond that is prejudicial to defendant's rights will require reversal.

The interpretation advanced by the dissent in the instant case places the emphasis upon the clause in Section 427, ". . . information required must be given . . ." [24] which it has taken out of context. This approach might unduly burden trial judges when confronted with irrelevancies from inexperienced jurors.

The Court has, in effect, applied the essence of Section 542 of the Code of Criminal Procedure: "After hearing the appeal, the court must give judgment, without regard to technical errors or defects or to exceptions which do not affect the substantial rights of the parties." [25] The result of the *La Marca* decision is to leave response to jury questions in the court's discretion.

FEDERAL JURISDICTION—STOCKHOLDER'S DERIVATIVE ACTION—HELD ANTAGONISM EXISTS WHEN MANAGEMENT IS ALIGNED

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[20] People v. Gezzo, 307 N.Y. 385, 396, 121 N.E.2d 380, 385 (1954), paraphrasing People v. Cooke, 292 N.Y. 185, 188, 54 N.E.2d 357, 359 (1944).

[21] People v. La Marca, 3 N.Y.2d 452, 462, 144 N.E.2d 420, 426 (1957).

[22] *Id.* at 461, 144 N.E.2d at 425. The *Cooke* majority opinion was written by Judge Desmond, who dissented in the instant case quoting the *Cooke* dissent.

[23] *Ibid.*

[24] *Id.* at 466-67, 144 N.E.2d at 429.

[25] N.Y. CODE CRIM. PROC. § 542. The court tacitly avoided the caveat of the *Cooke* dissent which said "no appellate court may disregard the error under section 542 of the Code of Criminal Procedure." People v. Cooke, 292 N.Y. 185, 193, 54 N.E.2d 357, 361 (1944).

AGAINST STOCKHOLDER.—Plaintiff brought a stockholder's derivative suit, alleging fraudulent waste of assets of Warner Bros. Pictures Inc. that benefited United States Pictures Inc. Both are Delaware corporations. The District Court, finding no basis of antagonism, realigned the stockholder's corporation as plaintiff and dismissed the action for lack of diversity of citizenship. In reversing, the Supreme Court *held* that there is antagonism whenever the management is aligned against the stockholder and defends a course of conduct which he attacks. Antagonism can be determined on the face of the pleadings and by the nature of the controversy. *Smith v. Sperling,* 354 U.S. 91 (1957).

The United States Constitution [1] confers upon the Supreme Court and such inferior courts as Congress may establish, jurisdiction of suits involving diversity of citizenship. The Judiciary Act of 1789 [2] established diversity jurisdiction in the lower federal courts and, through succeeding acts,[3] the extent of this jurisdiction was defined.[4] To sustain it, all the parties on one side of the controversy must be citizens of states different from the states of all the parties on the other side.[5]

In the area of stockholder's derivative suits, the courts have developed the principle of antagonism in order to bring these suits within the federal diversity jurisdiction. The cause of action in these suits properly belongs to the corporation [6] but the stockholder is forced to bring it because of the failure or inability of the corporation to act. His action is based upon an injury done to the corporation, not upon a personal wrong.[7] However, if the court aligned the parties according to their apparent interests in the dispute, the corporation would be on the same side of the controversy as the stockholder,[8] even though it had participated in the actions of which he complains. Should the defendant corporation, as in the instant case,

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[1] U.S. CONST. art. III, § 2.

[2] 28 U.S.C. § 41(1)(b) (1952).

[3] 28 U.S.C. §§ 71, 72 (1952); 28 U.S.C. § 41(1) (1952); 28 U.S.C. § 1332 (1952).

[4] See Frank, *Historical Basis of the Federal Judicial System,* 13 LAW & CONTEMP. PROB. 3, 28 (1948). "To summarize, the diversity jurisdiction . . . may fairly be said to be the product of three factors. . . .

1) The desire to avoid regional prejudice against commercial litigants. . . .

2) The desire to permit commercial, manufacturing, and speculative interests to litigate their controversies . . . before judges who would be firmly tied to their own interests.

3) The desire to achieve more efficient administration of justice for the classes thus benefited." *Ibid.*

[5] Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267 (1806).

[6] See Price v. Gurney, 324 U.S. 100 (1945).

[7] For a brief history of the development of the stockholder's derivative suit, see Prunty, *The Shareholder's Derivative Suit: Notes on Its Derivation,* 32 N.Y.U.L. REV. 980 (1957).

[8] See Koster v. Lumberman's Mut. Co., 330 U.S. 518 (1946).

be incorporated in the same state as the plaintiff's corporation,[9] the necessary diversity of citizenship would be lost since Delaware corporations would be on both sides of the controversy.

The requirements for antagonism were first brought out in the case of *Dodge v. Woolsey*.[10] The Court there held that a corporate bank and its directors were properly aligned as defendants since their actions in refusing to contest an unconstitutional tax upon the bank amounted to a breach of trust toward the suing stockholder. Antagonism was further defined by the case of *Doctor v. Harrington*,[11] which stated that in order to prevent realignment of the corporation as plaintiff, ". . . the stockholder's interests and the interests of the corporation must be . . . subservient to some illegal purpose . . ." [12] of the officers and directors. Thus the use of the principle of antagonism to support diversity jurisdiction has been ". . . cast normally in terms of some fraud, illegality or breach of trust" [13] in the acts of the corporate management which dominated the corporation. The District Court in the instant case, discovering no illegality by management, held that no collision of interest existed between plaintiff and his corporation and refused to find the necessary antagonism.[14]

Criticism [15] of the increased number of stockholder suits brought as a result of the *Dodge v. Woolsey* case caused the adoption of Equity Rule 94.[16] Rule 94, which is now Rule 23(b) of the Federal Rules of Civil Procedure, requires a showing by the suing stockholder of his efforts to stimulate management action or the reasons for not making such efforts, and is designed to prevent collusion [17] between management and stockholders in order to satisfy diversity jurisdiction requirements.

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[9] For the purpose of suing and being sued in the courts of the United States, a corporation created by and doing business in a state is to be considered a citizen of the state, and it is conclusively presumed by law that the stockholders of the corporation are citizens of the same state as the corporation. Barrow S.S. Co. v. Kane, 170 U.S. 100 (1898). However, the Court will in addition recognize that the plaintiff stockholders are citizens of a different state in prosecuting a derivative action on behalf of the corporation. Doctor v. Harrington, 196 U.S. 579 (1905).

[10] 59 U.S. (18 How.) 331 (1855).

[11] 196 U.S. 579 (1905).

[12] Doctor v. Harrington, 196 U.S. 579, 587 (1905).

[13] Smith v. Sperling, 354 U.S. 91, 95 (1957).

[14] Smith v. Sperling, 117 F. Supp. 781, 804-05 (1953).

[15] Hawes v. Oakland, 104 U.S. 450, 452 (1881). "In certain cases where a corporation wished to litigate a case in the federal courts, if the suit was brought by the corporation there would have been no jurisdiction on the ground of diversity of citizenship. It became a practice in order to get such cases into the federal courts, to arrange either to have a non-resident shareholder sue the corporation . . . or have shares transferred to a non-resident who would, upon formal refusal of the board of directors to act, bring a derivative suit in the federal courts." BALLANTINE, CORPORATIONS 357 (rev. ed. 1946).

[16] Rule 94 was later followed as Equity Rule 27 and is now embodied in Rule 23(b).

[17] See Hawes v. Oakland, note 15 *supra*.

The instant case may increase the scope of federal diversity jurisdiction in the area of stockholder's derivative suits [18] and relax the traditional concept of antagonism. To bring the case in a federal court, the stockholder need no longer charge fraud or illegality but only has to show an honest collision of interest with the corporate management. The court will "determine the issue of antagonism on the face of the pleadings and by the nature of the controversy." [19] It seems that the issue of whether there was collusion was the sole factor that prompted the courts to go into the question of realignment.[20] There was no claim of collusion in the *Sperling* case.

In overturning the requirements which the District Court declared necessary to establish antagonism, the Court was motivated by a belief that the problems raised by the old rule did not properly belong to the preliminary issue of jurisdiction.[21] "To stop and try the charge of wrongdoing" [22] by management is to decide an issue which belongs to the merits, the Court said. The lower court determined after a fifteen-day hearing that there was no evidence of wrongdoing by management. It thus went into the merits of the case to determine jurisdiction, a practice which the Supreme Court finds improper.

The validity of retaining the privilege of diversity jurisdiction has been questioned.[23] It is contended that sectional prejudice is at an end and businessmen no longer need to fear local courts.[24] Advocates of this view see diversity jurisdiction as an invasion of the jurisdiction of state courts.[25]

The opposing view believes that diversity jurisdiction has contributed greatly to the commercial development and unity of the

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[18] Smith v. Sperling, 354 U.S. 91, 105 (1957) (dissenting opinion).

[19] *Id.* at 96.

[20] Koster v. Lumberman's Mut. Co., 330 U.S. 518 (1946); Chicago v. Mills, 204 U.S. 321 (1907); Dawson v. Columbia Trust Co., 197 U.S. 178 (1905).

[21] 354 U.S. at 95 (1957).

[22] *Ibid.*

[23] See HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 894 (1953); Frankfurter, *Distribution of Judicial Power Between United States and State Courts,* 13 CORNELL L.Q. 499, 521 (1928).

"In many ways the worst part of diversity jurisdiction is that it debases the judicial process, reducing federal judges to what Judge Frank has called 'ventriloquist's dummy to the courts of some particular state'—because they lack the requisite authority to speak themselves." HART & WECHSLER, *op. cit. supra* at 895.

[24] See HART & WECHSLER, *op. cit. supra* note 23, at 897; Frankfurter, note 23 *supra.*

[25] See McGovney, *A Supreme Court Fiction 1,* 56 HARV. L. REV. 853, 860 (1943).

". . . [N]ational courts have invaded the autonomy thus reserved to the states in an important class of cases. . . . [T]he administration of state law in cases in which a state-created corporation is a party is usurped by the national courts. . . ." *Ibid.*

United States,[26] and in today's expanded and complex business world, it retains its importance.[27] The decision in the instant case would appear to place the Supreme Court in accord with this view.

Despite the possibility, pointed out by the dissent,[28] of an increased number of stockholder suits burdening the federal courts,[29] the Supreme Court is strengthening the guarantee of an impartial forum wherein stockholder suits may be used to enforce corporate responsibility ". . . without destroying the right of a majority of the members of a corporate body to govern the affairs of that body." [30]

INTERNATIONAL LAW — CONSTITUTIONAL LAW — TREATIES — EXERCISE OF WAIVER PROVISION IN JAPANESE PROTOCOL HELD CONSTITUTIONAL.—On a petition for a writ of habeas corpus and other relief, the District Court for the District of Columbia [1] enjoined the United States authorities from delivering an American soldier to the Japanese Government for trial in the killing of a Japanese citizen.

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[26] See Parker, *The Federal Jurisdiction and Recent Attacks Upon It,* 18 A.B.A.J. 433, 437 (1932). Judge Parker says of diversity jurisdiction:

"No power exercised under the Constitution has . . . had greater influence in welding these United States into a single nation; nothing has done more to foster interstate commerce and communication and uninterrupted flow of capital for investment into the various parts of the Union; and nothing has been so potent in sustaining the public credit and the sanctity of private contracts." *Ibid.*

[27] See JUDICIAL CONFERENCE OF THE UNITED STATES, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 81 (1955).

[28] The dissent declares: "Refusal to sue provides automatic entry." Smith v. Sperling, 354 U.S. 91, 105 (1957) (dissenting opinion).

[29] See Frankfurter, *Distribution of Judicial Power Between United States and State Courts,* 13 CORNELL L.Q. 499 (1928). For a statistical survey of the amount of diversity of citizenship litigation in the federal courts, see JUDICIAL CONFERENCE OF THE UNITED STATES, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 94 (1955).

[30] Prunty, *The Shareholder's Derivative Suit: Notes on Its Derivation,* 32 N.Y.U.L. REV. 980, 993 (1957).

[1] Girard v. Wilson, 152 F. Supp. 21 (D.D.C. 1957). The respondent Girard, while guarding a machine gun during a small unit exercise at Camp Weir range area in Japan, had shot and killed a Japanese woman who was gathering expended cartridge cases in the area. The United States claimed the right to try Girard upon the ground that his act, as certified by his commanding officer, was "done in the performance of official duty." Japan contended that his act was not in the line of duty and that therefore Japan had the right to try him. The matter was considered by a Joint Committee which was unable to agree. Thereafter, the United States authorities notified Japan that Girard would be turned over to them for trial. It was at this point that Girard petitioned the district court.