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Gordon v. Elliman–A Further Inroad Upon the Rights of Minority Stockholders

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No matter which view is adopted, the plaintiff is nonsuited if the period of limitation has run out, regardless of whether or not his damages are as yet ascertainable,[43] just as in the negligence situation earlier discussed.

The conflicting demands made by plaintiff and defendant of the courts and legislatures in ascertaining the limitation of a particular action lend emphasis to a moral problem in the law. While the one party is entitled to that peace of mind which comes with the knowledge that ancient adverse claims have been laid to rest, the other is, in common justice, entitled to a remedy *after* he knows that he is injured, and what his injuries are. In this latter respect there are deficiencies in the law in both of the grounds of action here discussed. Opinions such as that in the *Dincher* case not only fail to achieve substantial justice, but tend to bring the law into disrepute among laymen. While the law is more sensibly interpreted in the breach of implied warranty situation, the plaintiff, in New York, might still find that he has not any practical remedy. As long as such a condition prevails, it cannot be said that an adequate form of justice is being afforded to injured vendees by the courts in this State.

GORDON v. ELLIMAN—A FURTHER INROAD UPON THE RIGHTS OF MINORITY STOCKHOLDERS

Rights of Shareholders

It is now well settled that a corporation is an entity separate and distinct from the members that comprise it.[1] It is capable of owning property in its name,[2] making its own contracts,[3] and may sue or be sued in its own right. But being an "entity," recognizable only in law, it is necessary that it act through the agency of the members that comprise it. The law, therefore, has provided that the management of a corporation shall be in the board of directors,[4] and the stock-

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[43] New Amsterdam Casualty Co. v. Baker, *supra* note 41.

[1] *See* Warrior River Terminal Co. v. State, 257 Ala. 208, 58 So.2d 100, 101 (1952); Corporation Comm'n v. Consolidated Stage Co., 63 Ariz. 257, 161 P.2d 110, 111 (1945); Miller v. McColgan, 17 Cal.2d 432, 110 P.2d 419, 421 (1941).

[2] *See* Corporation Comm'n v. Consolidated Stage Co., *supra* note 1; Miller v. McColgan, *supra* note 1; Button v. Hoffman, 61 Wis. 20, 20 N.W. 667, 668-669 (1884).

[3] *See* Bank of Augusta v. Earle, 13 Pet. 519, 587 (U.S. 1839).

[4] N.Y. GEN. CORP. LAW § 27. "The business of a corporation shall be managed by its board of directors. . . ."

holder, as such, has no right to participate in the corporate business. There are instances where the directors must obtain the consent of the stockholders before they can act,[5] but this is in extraordinary matters and not in the general course of business. In the usual case, the stockholder is limited to the right to vote his shares in the election of directors.[6] It is not surprising, therefore, that the stockholder's interest has been described as a mere equitable interest in the corporate assets.[7]

By its very nature and composition, it is readily determinable that a stockholder, as such, has very limited rights in a corporation. The law, however, has accorded to him some rights.[8] One major right is that the directors may be compelled to act for the benefit of the corporation and the stockholders, and not for their own personal benefit.[9] This follows from the proposition that a director acts in a fiduciary capacity,[10] and any breach of this relationship will allow an action in equity.[11]

Individual and Derivative Suits

A stockholder is not limited to such equitable actions, and on occasion, as in an action on a note, he may sue in a court of law. However, for the purposes of this article, we are concerned with actions arising out of the stockholder-corporation relationship. Such suits may be either *individual, derivative,* or a combination of both.

An action is said to be "individual" when the stockholder commences the action in his own behalf to enforce a personal right.[12] The essence of such an action is that the individual stockholder is the one injured, as distinguished from the corporation, which has no cause for complaint.[13] Any benefits or recovery awarded as a result of the action inure to the individual directly, and not to the corporation.[14]

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[5] *E.g.,* N.Y. STOCK CORP. LAW § 20 (Consent of two-thirds of the shareholders is required before the directors can sell its integral assets.).

[6] See BALLANTINE, CORPORATIONS § 158 (Rev. ed. 1946).

[7] *See* Waller v. Waller, 187 Md. 185, 49 A.2d 449, 453 (1946).

[8] See note 6 *supra* (gives a complete breakdown of the rights of a shareholder).

[9] *Ibid.*

[10] See Uhlman, *The Legal Status of Corporate Directors,* 19 B.U.L. REV. 12 (1939) (This article points out the diversity of legal opinion as to whether directors are trustees or agents and concludes that in reality they are neither, but are held to a separate fiduciary relationship.).

[11] *See* Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 547-548 (1949); Waller v. Waller, *supra* note 7.

[12] See PRASHKER, CASES AND MATERIALS ON CORPORATIONS 786-787 (2d ed. 1949).

[13] *See* Niles v. New York Cent. & H.R.R.R., 176 N.Y. 119, 123-124, 68 N.E. 142, 144 (1903). See PRASHKER, *op. cit. supra* note 12, at 786, 787.

[14] *See* Ames v. Voit, 97 F. Supp. 89, 92 (S.D. N.Y.), *rev'd on other grounds sub nom.* Ames v. Mengel Co., 190 F.2d 344 (2d Cir. 1951); see PRASHKER, *op. cit. supra* note 12.

Mere decline in value of stock, due to dissipation of corporate assets, however, is not a sufficient ground for a stockholder to bring an individual action.[15] This is so because a recovery by the corporation would raise the value of his stock ratably with that of the other stockholders; he has no direct recovery for he has suffered no individual injury. Examples of an individual cause of action are where a shareholder sues to enforce his preemptive rights;[16] to compel a corporation to pay a declared dividend;[17] or to compel a stock transfer in the stock book.[18]

A derivative suit, however, as distinguished from an individual suit is brought by a stockholder to enforce a corporate cause of action.[19] It is equity's method of providing a remedy or preventing a wrong to a corporation by its officers or directors when the corporation, because it is controlled by the wrongdoers or for other reasons, fails to take appropriate action for its own protection.[20] The essence of this type of suit is that the remedy sought is for the injury done to the corporation and that any recovery must inure to the benefit of the corporation.[21] The stockholder, bringing the action in behalf of the corporation, acts analogously to a beneficiary of a trust who brings an action after the trustee has failed to do so.[22] Two common examples of a derivative action are for the mismanagement and waste of directors,[23] and for the improper payment of salaries and bonuses.[24]

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[15] *See* Niles v. New York Cent. & H.R.R.R., *supra* note 13; Remy Beverages, Inc. v. Myer, 56 N.Y.S.2d 828, 831 (Sup. Ct.), *aff'd mem.*, 269 App. Div. 1013, 59 N.Y.S.2d 371 (1st Dep't 1945).

[16] See, *e.g.*, Ames v. Voit, *supra* note 14; Witherbee v. Bowles, 201 N.Y. 427, 95 N.E. 27 (1911); Stokes v. Continental Trust Co., 186 N.Y. 285, 78 N.E. 1090 (1906).

[17] See, *e.g.*, Johnson v. Moore, 31 Ariz. 137, 250 Pac. 995, 998 (1926); Jefferis v. William D. Mullen Co., 15 Del. Ch. 144, 132 Atl. 687, 688 (1926).

[18] See, *e.g.*, Jessup v. Chicago & N.W. Ry., 188 Fed. 931 (C.C.S.D.N.Y. 1911); Travis v. Knox Terpezone Co., 215 N.Y. 259, 109 N.E. 250 (1915).

[19] *See* Price v. Gurney, 324 U.S. 100, 105 (1945); Teich v. Lawrence, 291 N.Y. 245, 249, 52 N.E.2d 115, 116 (1943); Isaac v. Marcus, 258 N.Y. 257, 264, 179 N.E. 487, 489 (1932); Continental Securities Co. v. Belmont, 206 N.Y. 7, 15, 99 N.E. 138, 141 (1912). See PRASHKER, CASES AND MATERIALS ON CORPORATIONS 787 (2d ed. 1949); BALLANTINE, CORPORATIONS § 143 (Rev. ed. 1946).

[20] *See* Isaac v. Marcus, *supra* note 19. See PRASHKER, *op. cit. supra* note 19, at 787-788; BALLANTINE, CORPORATIONS § 143 (Rev. ed. 1946).

[21] *See* Price v. Gurney, *supra* note 19; Clarke v. Greenberg, 296 N.Y. 146, 149-150, 71 N.E.2d 443, 444-445 (1947); Isaac v. Marcus, *supra* note 19; see PRASHKER, *op. cit. supra* note 19, at 787-788; BALLANTINE, CORPORATIONS § 143 (Rev. ed. 1946).

[22] See PRASHKER, *op. cit. supra* note 19, at 788 n.7(a).

[23] See, *e.g.*, Ludlam v. Riverhead Bond & Mort. Corp., 244 App. Div. 113, 278 N.Y. Supp. 487 (2d Dep't 1935), *modified*, 248 App. Div. 908, 290 N.Y. Supp. 648 (2d Dep't 1936); Winter v. Anderson, 242 App. Div. 430, 275 N.Y. Supp. 373 (4th Dep't 1934); Gass v. Nelson, 82 N.Y.S.2d 641 (Sup. Ct. 1948), *modified*, 275 App. Div. 669, 87 N.Y.S.2d 218 (2d Dep't 1949).

[24] See, *e.g.*, Anglo-American Equities Corp. v. E. H. Rollins & Sons, Inc., 258 App. Div. 878, 16 N.Y.S.2d 105 (1st Dep't 1939), *aff'd mem.*, 282 N.Y.

While an individual and a derivative action are mutually exclusive, they may be joined in a single complaint if the facts give rise to two separate causes of action.[25]

At times, it becomes very important to determine which type of action to bring. As a general rule, the stockholder would prefer the individual type, as it eliminates the necessity of meeting all the prerequisites of a derivative suit [26] and any recovery will go directly to himself, and not to the corporation.[27] Also, the passage of Section 61-b of the General Corporation Law, requiring the posting of security for litigation expenses in derivative actions,[28] has made it almost imperative that the suit be classified as individual.

On the other hand, policy considerations have inclined the courts to favor the derivative action. Among these are the protection of third parties, *e.g.*, corporate creditors, and the prevention of the evasion of security statutes. Further, the courts apparently feel that a corporate recovery is a sufficient remedy in the average case.[29]

Gordon v. Elliman

The recent New York case of *Gordon v. Elliman* [30] presented this exact problem. The court was asked to determine whether an action by a minority stockholder, to compel the declaration of a dividend, was a derivative action, thereby requiring the plaintiff to post security, or whether it was an individual suit wherein no security would be required. The court held it to be derivative. This was a case of first impression and was decided by a sharply divided court, with three judges dissenting.[31]

Both text writers and judicial opinion are in open conflict on the question raised in the *Gordon* case. Professor Ballantine, in his text, states that the belief that such an action is derivative is "erroneous." [32]

782, 27 N.E.2d 200 (1940); Stearns v. Dudley, 76 N.Y.S.2d 106 (Sup. Ct. 1947), *aff'd mem.*, 274 App. Div. 1028, 86 N.Y.S.2d 478 (4th Dep't 1948).

[25] See, *e.g.*, Dreben v. Belloise, 275 App. Div. 755, 87 N.Y.S.2d 572 (1st Dep't 1949); Mayer v. Siller, 251 App. Div. 677, 297 N.Y. Supp. 341 (4th Dep't 1937).

[26] For a listing of the required prerequisites see 27 ST. JOHN'S L. REV. 360 (1953).

[27] See note 14 *supra.*

[28] This section, on motion by the corporation, requires a shareholder, the value of whose stock is $50,000 or less or under 5% of any class of stock, to post security for expenses entailed in the defense of a derivative suit.

[29] See Note, 40 CALIF. L. REV. 127, 130 (1952).

[30] 306 N.Y. 456, 119 N.E.2d 331 (1954).

[31] *Id.* at 480, 119 N.E.2d at 346.

[32] See BALLANTINE, CORPORATIONS § 234 (Rev. ed. 1946).

This view is shared by Moore in his work on federal practice,[33] but Fletcher has stated that "[s]uch an action is maintained by a stockholder, but in the right of the corporation, making it a party defendant." [34] There are conflicting decisions regarding this question in lower court opinions in this state [35] and those of foreign jurisdictions.[36] It is interesting to note that in the *Gordon* case proponents of each view claimed the weight of authority.[37]

The majority opinion there stated that the test as to which type action will lie is whether the stockholder sues to recover on a chose in action belonging to himself or other stockholders, or whether it is to compel the performance of a duty of a director running directly to the corporation and through it to the stockholder.[38] The court then decided that an action to compel the declaration of a dividend came within the scope of the latter classification. The court recognized that a derivative action implies that some benefit accrues to the corporation. Accordingly, it pointed out that the corporation is benefited by a sensible dividend policy, to the extent that it aids it in acquiring additional capital through the sale of new issues of stock,[39] and furthermore, that it prevents loss through taxation on excessive surpluses.[40]

The dissenting opinion pointed out the fallacy of the majority's test, in that it presupposes that every duty of a director runs exclusively to the corporation and never runs directly to the stockholders.[41] The minority maintained that an action to compel the declaration of a dividend is based upon ". . . a breach of a contract between the *stockholder* and the *corporation*." [42]

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[33] See 3 MOORE, FEDERAL PRACTICE 3508-3509 (2d ed. 1948).

[34] See 11 FLETCHER, CYCLOPEDIA CORPORATIONS 816-817 (Rev. ed. 1932).

[35] See, *e.g.*, Davidoff v. Seidenberg, 275 App. Div. 784, 88 N.Y.S.2d 5 (2d Dep't 1949); Pulsch v. Nyack Express Co., 253 App. Div. 734, 300 N.Y. Supp. 634 (2d Dep't 1937); Jones v. The Van Heusen Charles Co., 230 App. Div. 694, 246 N.Y. Supp. 204 (3d Dep't 1930); Kranich v. Bach, 209 App. Div. 52, 204 N.Y. Supp. 320 (1st Dep't 1924); Swinton v. W. J. Bush & Co., 199 Misc. 321, 102 N.Y.S.2d 994 (Sup. Ct.), *aff'd mem.*, 278 App. Div. 754, 103 N.Y.S.2d 1019 (1st Dep't 1951); Reid v. Long Island Bond & Mort. Guarantee Co., 198 Misc. 460, 98 N.Y.S.2d 739 (Sup. Ct. 1949), *aff'd mem.*, 277 App. Div. 888, 98 N.Y.S.2d 389 (2d Dep't 1950).

[36] See, *e.g.*, Crichton v. Webb Press Co., 113 La. 167, 36 So. 926 (1904); Lydia E. Pinkham Medicine Co. v. Gove, 303 Mass. 1, 20 N.E.2d 482 (1939); Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919); Raynolds v. Diamond Mills Paper Co., 69 N.J. Eq. 299, 60 Atl. 941 (1905); Stevens v. United States Steel Corp., 68 N.J. Eq. 373, 59 Atl. 905 (1905); Laurel Springs Land Co. v. Fougeray, 50 N.J. Eq. 756, 26 Atl. 886 (1893), *modified*, 57 N.J. Eq. 318, 41 Atl. 694 (1898).

[37] *See* Gordon v. Elliman, 306 N.Y. 456, 468, 478, 119 N.E.2d 331, 339, 345 (1954).

[38] *Id.* at 459, 119 N.E.2d at 333-334.

[39] *Id.* at 467, 119 N.E.2d at 338.

[40] *Ibid.*

[41] *Id.* at 470, 119 N.E.2d at 340.

[42] *Id.* at 472, 119 N.E.2d at 341.

It is submitted that the dissent was correct in condemning the test laid down by the majority. The relation of director and stockholder in New York is that of trustee and *cestui que trust*,[43] and there are many duties running directly from the director to the shareholder for the breach of which an action will lie.[44] The declaration of a dividend comes within this description. The right to dividends is an incident of the ownership of stock.[45] An average stockholder invests his money with the expectation of receiving a return in the form of a dividend if the corporation makes a profit. The directors may not needlessly and in bad faith refuse to declare this dividend.[46] Rather, as the court in *Lindgrove v. Schluter & Co.*[47] stated, "[t]he directors of a corporation *owe* a duty to their *stockholders* to exercise an impartial judgment in reference to the declaration of dividends, and to declare them *only* when, under the existing circumstances, a declaration will seem best to serve the corporate interests. . . ." It is to be noted that the directors have two separate duties in such an instance: first, to the stockholders to declare reasonable dividends, and secondly, to the corporation to exercise sound business discretion. It is for the breach of the first duty that an action to compel the declaration of a dividend is brought. This is based upon a factual showing that to do so would not compel the directors to violate their second duty owing to the corporation.

There is another objection to the test, not mentioned by the dissent, *i.e.*, it is too limited. It does not consider all the essential elements universally attributed to each type of action, or their basic differences, as were set forth earlier.[48] The court should have determined from the facts just who the injured party was, the corporation or the individual, and further, which one stood to be benefited if the action were brought to a successful conclusion. There can be no real doubt that in an action to compel the declaration of a dividend the answer to both questions would be the individual. The benefits referred to in the majority opinion are only secondary or collateral and do not form the basis of the suit.

The dissent's contention, however, that the action is based upon contract is misleading and may lead to erroneous thinking. The stockholder is entitled to dividends as a matter of right, but only after they are declared, in the discretion of the directors.[49] When

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[43] *See* Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 193, 123 N.E. 148, 151 (1919); Hiscock v. Lacy, 9 Misc. 578, 592-594, 30 N.Y. Supp. 860, 869-870 (Sup. Ct. 1894).

[44] See notes 16 and 18 *supra*.

[45] *See* Matter of Starbuck, 251 N.Y. 439, 445, 167 N.E. 580, 581 (1929).

[46] *See* Lockley v. Robie, 276 App. Div. 291, 296, 94 N.Y.S.2d 335, 339-340 (4th Dep't), *modified*, 301 N.Y. 371, 93 N.E.2d 895 (1950).

[47] 256 N.Y. 439, 444, 176 N.E. 832, 833 (1931) (emphasis added).

[48] See notes 13 and 19 *supra*.

[49] A. Rosen & Sons v. Silverman, 235 App. Div. 524, 258 N.Y. Supp. 15 (1st Dep't 1932); Jones v. The Van Heusen Charles Co., 230 App. Div. 694,

he invests in a corporation he has the mere hope or expectation of receiving a dividend,[50] and such expectation is not enforceable in any action at law or in equity. When the stockholder purchases his shares, he submits his funds to the control of the board of directors, who act in the nature of trustees.[51] If the directors breach their fiduciary relationship and withhold dividends, either arbitrarily[52] or in bad faith,[53] then an action will lie. It is to be noted, however, that the action is for the breach of duty and not on any contractual right. One may contract with the corporation so as to provide for a certain dividend,[54] but such contracts are never implied.

Just as the two opinions differed as to whether the action was derivative or not, they differed further on the applicability of Section 61-b of the General Corporation Law. The majority held that so long as the action is derivative, then of necessity Section 61-b must apply. However, it went further, and, in rebuttal to one of the dissent's arguments, said that secret settlements by directors were not the only evil sought to be remedied by the Section.[55] The solution lies in the history of Section 61-b.

Section 61-b

Prior to the enactment of the section, there were considerable abuses of the derivative action.[56] To overcome these evils, the Legislature, acting upon a report by one Franklin Wood,[57] enacted the "security for expenses" statute. The theory behind the statute was that a holder of less than the statutory amount was deemed to be acting in bad faith, as his own personal benefit would be almost negligible.[58] The passage of the statute met with determined opposi-

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246 N.Y. Supp. 204 (3d Dep't 1930); see BALLANTINE, CORPORATIONS § 158 (Rev. ed. 1946).

[50] See PRASHKER, CASES AND MATERIALS ON CORPORATIONS 496 (2d ed. 1949).

[51] This follows from the law entrusting the management of the corporation to the board of directors. N.Y. GEN. CORP. LAW § 27.

[52] *See* Lockley v. Robie, 276 App. Div. 291, 296, 94 N.Y.S.2d 335, 339-340 (4th Dep't), *modified*, 301 N.Y. 371, 93 N.E.2d 895 (1950); see Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919).

[53] See Reid v. Long Island Bond & Mort. Guarantee Co., 198 Misc. 460, 98 N.Y.S.2d 739 (Sup. Ct. 1949), *aff'd mem.*, 277 App. Div. 888, 98 N.Y.S.2d 389 (2d Dep't 1950); Hasset v. S. F. Iszard Co., 61 N.Y.S.2d 451 (Sup. Ct. 1945); Hiscock v. Lacy, 9 Misc. 578, 30 N.Y. Supp. 860 (Sup. Ct. 1894).

[54] See, *e.g.*, Boardman v. Lake Shore & Mich. So. Ry., 84 N.Y. 151, 173-174 (1881); Wessel v. Crosse & Blackwell, Ltd., 152 Misc. 814, 274 N.Y. Supp. 980 (N.Y. Munic. Ct. 1934).

[55] Gordon v. Elliman, 306 N.Y. 456, 469, 119 N.E.2d 331, 339 (1954).

[56] See Note, 34 COL. L. REV. 1308 (1934).

[57] See WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS (N.Y. Chamber of Commerce 1944).

[58] Noel Associates, Inc. v. Merrill, 184 Misc. 646, 655, 53 N.Y.S.2d 143, 152 (Sup. Ct. 1944).

tion from text writers,[59] but found favor in other jurisdictions.[60] A reading of the Wood Report and the Governor's "memorandum" accompanying the act [61] leaves little doubt that the purported purpose was to eliminate "strike suits." A "strike suit" is any action brought, not to redress any real wrong, nor to aid the corporation, but rather to fulfill some ulterior motive of the person commencing the action.[62]

Notwithstanding the dissent's contention, a "strike suit" may be brought for varied reasons, and not only to obtain secret settlements from erring directors. An action may be brought for its nuisance value alone; [63] or to partake in the large allotment of counsel fees in successful actions.[64] Occasionally it is used as a method of aiding a competitor; [65] or a situation might occur where it can be used as a tool for corporate reorganization.

However, the history of the cases shows that the "strike suit" was usually instigated to share in the large counsel fees, or to coerce erring directors to make secret settlements. A quick analysis of the action to compel the declaration of a dividend will show that it lends itself very poorly to the accomplishment of these results. There is no large pecuniary benefit or saving to the corporation which would

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[59] See PRASHKER, CASES AND MATERIALS ON CORPORATIONS 806-808 (2d ed. 1949); Ballantine, *Abuses of Shareholders Derivative Suits: How Far is California's New "Security for Expenses" Act Sound Regulation?*, 37 CALIF. L. REV. 399 (1949); Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 32 CALIF. L. REV. 123 (1944); Legis., 24 ST. JOHN'S L. REV. 326 (1950).

[60] *E.g.*, N.J. STAT. ANN. tit. 14, § 14:3-15 (Supp. 1953); PA. STAT. ANN. tit. 12, § 1322 (Purdon, 1953) (no $50,000 alternative to 5% requirement); WIS. STAT. § 180.405 (1953) (only 3% is required with no $50,000 alternative requirement); CAL. CORP. CODE § 834 (Deering, 1953) (no minimum requirements, but applies to all stockholders, if at a pretrial hearing it is shown that there is no reasonable possibility that the corporation or its stockholders will benefit).

[61] Public Papers of Governor Dewey (1944), as quoted in Lapchak v. Baker, 298 N.Y. 89, 80 N.E.2d 751 (1948). "In recent years a veritable racket of baseless lawsuits accompanied by many unethical practices has grown up in the field. Worse yet, many suits that were well based have been brought, not in the interest of the corporation or of its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or in its stockholders." *Id.* at 94-95, 80 N.E.2d at 753-754.

[62] A "strike suit" has also been accurately defined as ". . . an action brought by a security holder, not in good faith, but, through the exploitation of its nuisance value, to force the payment of a sum disproportionate to the normal value of his interest as the price of discontinuance." Note, 34 COL. L. REV. 1308 (1934).

[63] *See* Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 548 (1949); see Note, 34 COL. L. REV. 1308 n.1 (1934).

[64] See Murphy v. North American Light & Power Co., 33 F. Supp. 567 (S.D. N.Y. 1940) ($200,000 fees); BALLANTINE, CORPORATIONS § 156 (Rev. ed. 1946); Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COL. L. REV. 784, 812-816 (1939); 28 ST. JOHN'S L. REV. 290, 291 (1954).

[65] See Note, 34 COL. L. REV. 1311 n.10 (1934).

enable the court to award large counsel fees; on the contrary, a favorable judgment would deplete the assets of the corporation. The directors are in no way pecuniarily liable, thus obviating any need for a secret settlement. Any of the other evils attributed to "strike suits" are more than overshadowed by the difficulty of the action itself and the probability of failure.[66]

Conclusion

In summary, therefore, there seems to be little justification for the court's ruling in the *Gordon* case. Under prior rules, the action was clearly defined as an individual suit, and not as a derivative one. Even if that were not so, however, the evils against which Section 61-b was designed were not present; nor were there any policy considerations that could have affected the court's decision. By its nature, an action to compel a declaration of a dividend precludes any infringement upon the rights of creditors.[67] There is no wrongful evasion of the security statute as it has been shown to be inapplicable.

As was stated earlier, stockholders have very few rights under the corporate system. The most important right, however, and the one that should rise above all others and should be protected the most is their right to appeal to the courts of equity in the nature of a derivative action to enforce the fiduciary relationship between the directors and the stockholders. This is even more true today than when the right was first recognized in England in 1843.[68]

Today's large corporations with their enormous amounts of capital contributed by thousands of small, scattered stockholders, offer a great temptation to directors to act for their own benefit with a disregard for the welfare of the corporation. This temptation is accentuated by the almost assured self-perpetuation of the directors by their control of the proxy vote. Prior to the enactment of Section 61-b, there always remained the deterrent of a stockholder's suit by way of a derivative action compelling them to account. This deterrent has lost much of its force.

By the passage of Section 61-b, the Legislature has not only failed to defend the stockholder's right to bring suit but, in the case of a small investor, has for all practical purposes taken this right away. Reprehensible as this may be, it has been overshadowed by

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[66] It is only in very clear and extreme cases that the abuse of directors' discretion will be interfered with by the courts. See Dodd, *The Modern Corporation, Private Property, and Recent Federal Legislation,* 54 HARV. L. REV. 917, 924-925 (1941).

[67] N.Y. STOCK CORP. LAW § 58 ("No stock corporation shall declare or pay any dividend which shall impair its capital, nor while its capital is impaired. . . .").

[68] 1942 LEG. DOC. NO. 65(J), REPORT, N.Y. LAW REVISION COMMISSION 481 (1942).

the court's decision in *Gordon v. Elliman.* By including an action to compel the declaration of a dividend within the confines of Section 61-b, the court has taken away one more right of the stockholder. Because of the inequitable results flowing from Section 61-b, one would expect the Court of Appeals to strictly construe it; however, it has adopted the opposite attitude. It appeared to go out of its way to hold that this type of action was within the Legislature's intention in enacting this section.

This case clearly illustrates the harshness and inequity of Section 61-b, and the firmness with which it is now rooted in our law. The remedy is in the Legislature. It is hoped that it will re-evaluate its position on this matter, and by open hearings,[69] obtain a solution that will both protect against "strike suits" and once more return to the minority stockholder his right to effectively demand fair treatment by the management.

THE ABUSE OF THE UNION WELFARE FUND—A PROPOSED REMEDY

There is a great deal of difference between the collective bargaining agreement of today and the bargaining agreement of yesterday. Whereas the latter merely concerned the negotiation of basic standards of wages and hours, provision for the well-being of the worker outside the factory is increasingly becoming part and parcel of the modern collective bargaining agreement. This trend has led to the establishment of union death and disability benefits commonly referred to as "welfare funds." [1] "The new point of view, namely, that it is desirable and proper for a union to write a contract that covers matters of health, welfare, vacation, retirement, in addition to hours and wages, brought new problems with it in the administration of such funds." [2] Of current national interest is the question of whether or not these funds should be put under state or federal regulation in order to prevent their dissipation through misappropriation or sheer mismanagement.

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[69] One of the criticisms against the passage of Section 61-b was that it was denied a public hearing. See Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York,* 32 CALIF. L. REV. 148 (1944).

[1] Some union leaders look upon these funds with disfavor since they believe that a union's task is solely to concern itself with wages and hours.

[2] See Dubinsky, *Safeguarding Union Welfare Funds,* 7 AMERICAN FEDERATIONIST 10 (July 1954).