Corporations--Is Action to Compel Declaration of Dividend Derivative? (Gordon v. Elliman, 280 App. Div. 655 (1st Dep't 1952))

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legislatures of various states can disagree on the method of solving this problem, it is submitted that the court's action in the instant case was improper as an undue usurpation of the legislative function, especially since it chose the least logical of the several possible solutions.

CORPORATIONS—Is ACTION TO COMPEL DECLARATION OF DIVIDEND DERIVATIVE?—In an action by a stockholder against a corporation and its directors to compel the declaration of a dividend, the corporation moved for an order requiring plaintiff to provide security for expenses, on the ground that the action was derivative within the meaning of the New York statute. The motion was granted. In affirming, the Appellate Division held that the present suit is within the statute since it is an action brought in the right of the corporation, and not in the personal right of the stockholder. Gordon v. Elliman, 280 App. Div. 655, 116 N. Y. S. 2d 671 (1st Dep't 1952).

A "derivative" action, cognizable only in Equity, is a suit by a stockholder to enforce a corporate cause of action. As conditions precedent to its institution and maintenance, the plaintiff must allege and prove that the corporation has been damaged, and a cause of action exists in its favor; that a demand has been made, but the corporation refuses to commence the action; and that he was a stockholder at the time of the transaction of which he complains. The corporation, of necessity, is made a party defendant, since the relief

4 See Price v. Gurney, 324 U. S. 100, 105 (1945); see Hawes v. Oakland, 104 U. S. 450 (1881) (comprehensive treatment of necessary elements of a derivative action).
6 Corbus v. Alaska Treadwell Gold Mining Co., 187 U. S. 455 (1903); NY PA NJ Utilities Co. v. Public Service Comm'n, 23 F. Supp. 313 (S. D. N. Y. 1938); see Brinkerhoff v. Bostwick, 88 N. Y. 52, appeal dismissed, 106 U. S. 3 (1882) (if demand shown to be futile, stockholder may dispense with it); Dumphy v. Travelers' Newspaper Ass'n, 146 Mass. 495, 16 N. E. 426 (1888) (plaintiff failed to show futility of demand).
7 N. Y. Gen. Corp. Law § 61 (he may also show that his stock thereafter devolved upon him by operation of law).
8 Davenport v. Dows, 18 Wall. 626 (U. S. 1873); see Jones v. Van Heusen
granted is a judgment against a third person in favor of said corporation.\textsuperscript{10}

A "direct" action, in contradistinction to a derivative one, is maintained in the individual right of the stockholder.\textsuperscript{11} Since the wrongful act of which he complains has caused direct injury to the stockholder, the fruits of any recovery will inure to his personal benefit.\textsuperscript{12}

The statute invoked in the instant case was enacted to curb the abuse of the derivative action by petty-interest stockholders,\textsuperscript{13} who prosecuted groundless suits which, because of their nuisance value, often resulted in unethical private settlements.\textsuperscript{14} The statute requires that a stockholder who brings a derivative action, if he own less than five per cent of the outstanding stock, unless its market value exceeds $50,000, must, upon motion of the corporation, provide security for expenses of the suit.\textsuperscript{15} The security-giving stockholder who loses the action is liable to the corporation for expenses. However, one who holds the required minimum interest in the corporation need not post security, nor is he liable for expenses to the corporation, even if he lose the action.\textsuperscript{16} It follows that a small-interest stockholder maintains a losing suit at his own expense, while a wealthy stockholder may maintain a losing suit at the expense of the corporation. This discriminative feature, \textit{inter alia}, has subjected the statute to severe criticism;\textsuperscript{17} but notwithstanding this, it was declared

\textsuperscript{13} See Wood, \textit{Survey and Report Regarding Stockholders' Derivative Suits} (N. Y. Chamber of Commerce 1944) (enactment of Section 61-b was based on this report).
\textsuperscript{15} N. Y. GEN. CORP. LAW § 61-b is to be read in conjunction with N. Y. GEN. CORP. LAW §§ 63-68, which provide for indemnity by corporation to successfully defending directors of corporation for their reasonable expenses in an action.
In the instant case, the court refused to follow an earlier Supreme Court decision which held this type of action to be direct. Instead, the court labeled it derivative, thereby bringing the action within the purview of the statute. This was predicated upon the theory that, in respect to dividends, the directors do not owe a duty to the stockholders as individuals, but only to the stockholders jointly, that is, to the corporation. This reasoning is specious, tending only to confuse.

A derivative action is necessarily based on damage to the corporation. The wrongful withholding of dividends is obviously an injury to the stockholders as individuals, thereby giving rise to a direct cause of action. The theory that the injured stockholders comprise the corporation, and, therefore, that the corporation has been damaged, is a rationalization which destroys the classic and thoroughly well-settled "corporate entity" doctrine. This "corporate entity" exists separate and distinct from the individuals composing it, and is thus unaffected by any injury which those individuals might suffer.

That this is a direct action is further evidenced by an examination of the recovery obtained. The court will order the directors to
do what they previously should have done—viz., declare a dividend.\textsuperscript{26} The court's decree should have the effect of relating back to the time when the directors should have done, what they are now being compelled to do; for had the directors performed their duty, a dividend would have been declared, payment of which could have been enforced by the stockholders in their personal right.\textsuperscript{27} The withholding of dividends has thus damaged the individual stockholders, and not the corporation. The stockholders are merely entitled to receive presently as benefit, what would have been theirs already, had the directors exercised their discretion properly.

It may be argued that since the legislative purpose of the enactment of Section 61-b was the preclusion of baseless suits, to preserve this intent, this plaintiff-stockholder should be forced to post security, since he does not hold the required minimum interest in the corporation.\textsuperscript{28} This contention is refuted by the fact that the statute was not intended to be applicable to an action of this nature, but was designed to preclude only baseless derivative suits.\textsuperscript{29}

Since the action in the instant case thus appears to be in the right of the individual stockholders, the present decision is questionable. This plaintiff-stockholder may be denied a remedy if he is incapable of posting the required security.\textsuperscript{30} Even if he can afford the security, he may refuse to do so, because of fear of consequential liability to the corporation in the event he loses the action. The judiciary's interpretation of what constitutes a derivative action, so as to include the present suit, thereby bringing it within the purview of Section 61-b, appears, in essence, to be an unconstitutional application by the court of a constitutional statute.\textsuperscript{31} Since the statute itself is used as a bludgeon on minority stockholders, rather than as an in-

\textsuperscript{26} "... Even though individual directors are joined as parties, [in action to compel declaration of dividend] they are not called upon to exercise any business discretion. The case has passed that point.... The court is declaring rights protected by a rule of law, not calling upon the directors to exercise judgment," Kroese v. General Steel Castings Corp., 179 F. 2d 760, 763-64 (3d Cir.), cert. denied, 339 U. S. 983 (1950).


\textsuperscript{28} See notes 14, 15 supra. On approving Laws of N. Y. 1944, c. 668, Governor Dewey stated in part: "Even if the stockholder owns only a tiny percentage or only $5.00 worth of stock, it still should be simple to bring an action without putting up security. If his action has any merit at all, it should be easy enough to interest others who do hold at least 5%, or stock valued at $50,000." Governor's Memorandum (1944).

\textsuperscript{29} See Wood, Survey and Report Regarding Stockholders' Derivative Suits (N. Y. Chamber of Commerce 1944).

\textsuperscript{30} Irrespective of his good faith, the action is branded as baseless, if plaintiff cannot muster sufficient support from other stockholders to defeat the security requirement.

strument of justice, the instant decision's extension of the theory of derivative actions, so as to include this direct type of action, is both reprehensible and inequitable.

EQUITY—PROPERTY RIGHT IN AN IDEA.—Plaintiff's idea for a radio program using talented school children was disclosed to defendant with the expectation of compensation should the idea be used. A program adopting plaintiff's idea was broadcast for over a year and sponsored by defendant. Plaintiff seeks to recover damages for the use of his idea. The court decided in plaintiff's favor, and held that a protectible property right exists in an idea which is original, novel, and reduced to concrete form, where it has been disclosed under circumstances indicating that compensation is expected for its use. Belt v. Hamilton National Bank, 108 F. Supp. 689 (D. D. C. 1952).

The flexible nature of the common law, and its ability to adjust itself to the changing needs of society, is evidenced by the gradual weakening of its original reluctance to recognize a property right in intangible property. The judicial viewpoint has undergone a metamorphosis since the days of the Impeachment of Lord Chief Justice Scroggs for enjoining an admittedly libellous publication because it injured an intangible right. The once unheard of right of privacy is now recognized by statute. Other intangible property rights not covered by statute are also protected. Trade names and business reputations are protected on the theory of unfair competition and dilution. It has been held that a person has a property right in personal letters, and in the protection of his good name. Trade

2 See Roberson v. Rochester Folding Box Co., 171 N. Y. 538, 64 N. E. 442 (1902) (refusal to enjoin the printing of plaintiff's picture); Hodecker v. Strickler, 39 N. Y. Supp. 515 (Sup. Ct. 1896) (refusal to enjoin unauthorized use of plaintiff's name); Brandreth v. Lance, 8 Paige 24 (N. Y. 1839) (libelous publication did not injure tangible property right); Prudential Assur. Co. v. Knott, L. R. 10 Ch. App. 142 (1875) (refusal to enjoin a libellous publication).
3 8 How. St. Tr. 197 (1680).