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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.[1] The motion was granted.[2] 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.[3] *Gordon v. Elliman,* 280 App. Div. 655, 116 N. Y. S. 2d 671 (1st Dep't 1952).

A "derivative" action, cognizable only in Equity,[4] is a suit by a stockholder to enforce a corporate cause of action.[5] 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;[6] that a demand has been made, but the corporation refuses to commence the action;[7] and that he was a stockholder at the time of the transaction of which he complains.[8] The corporation, of necessity, is made a party defendant,[9] since the relief

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[1] N. Y. GEN. CORP. LAW § 61-b.

[2] Gordon v. Elliman, 115 N. Y. S. 2d 567 (Sup. Ct. 1952).

[3] Callahan, J., dissenting.

[4] *See* Isaac v. Marcus, 258 N. Y. 257, 263, 179 N. E. 487, 489 (1932).

[5] *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] Waters v. Horace Waters & Co., 201 N. Y. 184, 94 N. E. 602 (1911); Lifshutz v. Adams, 285 N. Y. 180, 33 N. E. 2d 83 (1941); Moriarty v. James Butler Grocery Co., 261 App. Div. 20, 24 N. Y. S. 2d 105 (1st Dep't 1940), *aff'd mem.,* 286 N. Y. 687, 37 N. E. 2d 36 (1941); Scheinman v. National Container Corp., 165 Misc. 267, 300 N. Y. Supp. 780 (Sup. Ct. 1937).

[7] 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 Brinckerhoff v. Bostwick, 88 N. Y. 52, *appeal dismissed,* 106 U. S. 3 (1882) (if demand shown to be futile, stockholder may dispense with it); Dunphy v. Travelers' Newspaper Ass'n, 146 Mass. 495, 16 N. E. 426 (1888) (plaintiff failed to show futility of demand).

[8] N. Y. GEN. CORP. LAW § 61 (he may also show that his stock thereafter devolved upon him by operation of law).

[9] 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.[10]

A "direct" action, in contradistinction to a derivative one, is maintained in the individual right of the stockholder.[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.[12]

The statute invoked in the instant case was enacted to curb the abuse of the derivative action by petty-interest stockholders,[13] who prosecuted groundless suits which, because of their nuisance value, often resulted in unethical private settlements.[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.[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.[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, *inter alia,* has subjected the statute to severe criticism;[17] but notwithstanding this, it was declared

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Charles Co., 230 App. Div. 694, 697, 246 N. Y. Supp. 204, 209 (3d Dep't 1930).

[10] *Cf.* Clarke v. Greenberg, 296 N. Y. 146, 71 N. E. 2d 443 (1947).

[11] See Schreiber v. Butte Copper & Zinc Co., 98 F. Supp. 106 (S. D. N. Y. 1951).

[12] *See* General Rubber Co. v. Benedict, 215 N. Y. 18, 22, 109 N. E. 96, 97 (1915); Niles v. N. Y. C. & H. R. R. R., 176 N. Y. 119, 123-24, 68 N. E. 142, 144 (1903).

[13] See WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS (N. Y. Chamber of Commerce 1944) (enactment of Section 61-b was based on this report).

[14] *See* Shielcrawt v. Moffett, 294 N. Y. 180, 190, 61 N. E. 2d 435, 439-40 (1945); Isensee v. L. I. Motion Picture Co., 184 Misc. 625, 628-29, 54 N. Y. S. 2d 556, 559 (Sup. Ct. 1945); see WOOD, *op. cit. supra* note 13.

[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.

[16] Isensee v. L. I. Motion Picture Co., *supra* note 14.

[17] See Citron v. Mangel Stores Corp., 50 N. Y. S. 2d 416 (Sup Ct.), *aff'd mem.,* 268 App. Div. 905, 51 N. Y. S. 2d 754 (1st Dep't 1944); Bowes, *Should New York's "Security for Expenses" Act Be Amended?,* 2 SYRACUSE L. REV. 37 (1950); Ballantine, *Abuses of Shareholders Derivative Suits: How Far is California's New "Security for Expenses" Act Sound Regulation?,* 37 CALIF. L. REV. 399 (1949) (comparison made between N. Y. and Calif. statutes); Note, 24 N. Y. U. L. Q. REV. 395 (1949); Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York,* 32 CALIF. L. REV. 123

constitutional in *Lapchak v. Baker*.[18]

In the instant case, the court refused to follow an earlier Supreme Court decision which held this type of action to be direct.[19] Instead, the court labeled it derivative, thereby bringing the action within the purview of the statute.[20] 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.[21]

A derivative action is necessarily based on damage to the corporation.[22] The wrongful withholding of dividends is obviously an injury to the stockholders as individuals, thereby giving rise to a direct cause of action.[23] 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.[24] This "corporate entity" exists separate and distinct from the individuals composing it,[25] 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

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(1944); Legis., 24 ST. JOHN'S L. REV. 326 (1950); PRASHKER, CASES AND MATERIALS ON CORPORATIONS 807, 808 (2d ed. 1949).

[18] 298 N. Y. 89, 80 N. E. 2d 751 (1948). *Contra:* Citron v. Mangel Stores Corp., *supra* note 17. Similar laws have been enacted in other states: CAL. CORP. CODE § 834 (1949); N. J. STAT. ANN. tit. 14, c. 3, § 15 (Supp. 1952); PA. STAT. ANN. tit. 12, § 1322 (Purdon Supp. 1952).

[19] 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), *leave to appeal denied,* 278 App. Div. 823, 105 N. Y. S. 2d 408 (1st Dep't 1951).

[20] *Accord,* Jones v. Van Heusen Charles Co., 230 App. Div. 694, 246 N. Y. Supp. 204 (3d Dep't 1930) (distinguished in Swinton v. W. J. Bush & Co., *supra* note 19); see 11 FLETCHER, CYC. CORPORATIONS §§ 5325-5327 (Perm. ed. 1932).

[21] According to this theory, a corporation is comprised of three entities: the stockholders *individually;* the stockholders *jointly*—the corporation; and the *corporation*—that invisible, artificial person existing only in contemplation of law.

[22] See note 6 *supra.*

[23] Swinton v. W. J. Bush & Co., *supra* note 19; *accord,* Kassel v. Empire Tinware Co., 178 App. Div. 176, 164 N. Y. Supp. 1033 (2d Dep't 1917); *see* Giesecke v. Denver Tramway Corp., 81 F. Supp. 957, 961 (D. Del. 1949); Starring v. Kemp, 167 Va. 429, 188 S. E. 174, 177 (1936) (stockholders benefit by the action, while the corporation merely acts as their collecting agent); see BALLANTINE, CORPORATIONS § 234 (Rev. ed. 1946) (suit is in the right of the individual stockholders as a class).

[24] *See* Klein v. Board of Tax Supervisors, 282 U. S. 19, 24 (1930); Trustees of Dartmouth College v. Woodward, 4 Wheat. 518, 636 (U. S. 1819).

[25] People's Pleasure Park Co. v. Rohleder, 109 Va. 439, 61 S. E. 794 (1908).

do what they previously should have done—*viz.*, declare a dividend.[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.[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.[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.[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.[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.[31] Since the statute itself is used as a bludgeon on minority stockholders, rather than as an in-

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[26] ". . . [E]ven 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 . . . . [T]he 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).

[27] *See* Jaques v. White Knob Copper & Development Co., 260 App. Div. 640, 641, 23 N. Y. S. 2d 326, 328 (1st Dep't 1940).

[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).

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

[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.

[31] See Citron v. Mangel Stores Corp., 50 N. Y. S. 2d 416 (Sup. Ct.), *aff'd mem.*, 268 App. Div. 905, 51 N. Y. S. 2d 754 (1st Dep't 1944).

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,[1] is evidenced by the gradual weakening of its original reluctance to recognize a property right in intangible property.[2] The judicial viewpoint has undergone a metamorphosis since the days of the *Impeachment of Lord Chief Justice Scroggs*[3] for enjoining an admittedly libellous publication because it injured an *intangible* right. The once unheard of right of privacy is now recognized by statute.[4] 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.[5] It has been held that a person has a property right in personal letters,[6] and in the protection of his good name.[7] Trade

[1] *See* Liggett & Meyer Tobacco Co. v. Meyer, 101 Ind. App. 420, 194 N. E. 206, 210 (1935).

[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) (libellous 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).

[4] N. Y. CIV. RIGHTS LAW §§ 50, 51.

[5] See Stork Restaurant, Inc. v. Sahati, 166 F. 2d 348 (9th Cir. 1946); Tiffany & Co. v. Tiffany Productions, Inc., 147 Misc. 679, 264 N. Y. Supp. 459 (Sup. Ct.), *aff'd,* 237 App. Div. 801, 260 N. Y. Supp. 821 (1st Dep't 1932), *aff'd mem.,* 262 N. Y. 482, 188 N. E. 30 (1933).

[6] Baker v. Libbie, 210 Mass. 599, 97 N. E. 109 (1912) (plaintiff may restrain the publication of personal letters); Gee v. Pritchard, 2 Swans. 402, 36 Eng. Rep. 670 (1818).

[7] Niver v. Niver, 200 Misc. 993, 111 N. Y. S. 2d 889 (Sup. Ct. 1951), 27 ST. JOHN'S L. REV. 144 (1952).