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CORPORATIONS - DERIVATIVE SUITS - INSOLVENCY AS A BAR

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CORPORATIONS — DERIVATIVE SUITS — INSOLVENCY AS A BAR — Plaintiff, stockholder in defendant bank, brought a derivative suit against the bank's directors to recover moneys allegedly wrongfully appropriated by them from the bank's assets. Before the commencement of the suit the bank had become insolvent and was in the process of liquidation. *Held*, the directors' motion to dismiss should be granted, since a stockholder may not maintain an action to hold an insolvent corporation's directors liable for fraud or mismanagement unless it appears that he will be benefited by the relief demanded, and full recovery here would still leave an excess of liabilities over assets. *Falvey v. Foreman-State National Bank*, (C. C. A. 7th, 1939) 101 F. (2d) 409.

The decision seems to be in accord with the general rule,¹ and is really an application of the doctrine that in bringing a derivative suit a stockholder must show an indirect injury² to himself as well as an injury to the corporation.³ If the corporation is so far insolvent that no assets will be available to stockholders on dissolution after creditors have been satisfied, a stockholder is not injured by the misappropriation of assets, since his stock is worthless,⁴ even though he has the right to have the assets devoted solely to corporate purposes while the corporation is solvent.⁵ The principal reasons for limiting a stockholder's right to maintain a derivative action are: (1) such a suit is an interference with the discretion of the corporation's management, who may deem it inadvisable to sue; (2) it may be difficult or impossible for a stockholder to obtain necessary evidence, which leads to a harsh result, because the suit is binding upon the corporation and the shareholders, despite the fact that the suit may be badly handled; ⁶ (3) the suit may be for "strike" purposes; or (4) it

¹ *Williams v. Neville*, 98 Miss. 268, 53 So. 594 (1910); *Darragh v. Wetter Mfg. Co.*, (C. C. A. 8th, 1897) 78 F. 7; 4 COOK, CORPORATIONS, 8th ed., § 735 (1923).

² 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, perm. ed., § 5948 (1932); *Babcock v. Farwell*, 245 Ill. 14, 91 N. E. 683 (1910). If the corporation is solvent, injury to the stockholder will be presumed, since allegations in the complaint concerning depreciation in value of the stockholder's shares in consequence of wrongs to the corporation on account of which the bill is filed, may be stricken out as irrelevant. *Kavanaugh v. Commonwealth Trust Co.*, 181 N. Y. 121, 73 N. E. 562 (1905).

³ 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, perm. ed., § 5948 (1932).

⁴ *Campbell v. Anniston Office Bldg. Co.*, (C. C. A. 5th, 1934) 73 F. (2d) 789.

⁵ 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, § 5826 (1932).

⁶ *Dana v. Morgan*, (C. C. A. 2d, 1916) 232 F. 85.

may be collusive. In the instant case there is the additional reason that the stockholder has no personal interest in the outcome of the suit, hence he may not prosecute it as vigorously as the interests of the creditors require. Whether a stockholder, in bringing a derivative action, be regarded as the voluntary representative⁷ or guardian ad litem⁸ of the corporation, or whether such suit is essentially one for specific performance of the corporation's duty to the stockholders,⁹ a stockholder of an insolvent corporation has not sufficient interest to allow him to enforce the claims of creditors, who are the real parties in interest, especially since upon insolvency the assets of the insolvent become a trust fund for the benefit of creditors.¹⁰ The present decision seems clearly justified.

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⁷ *Foss v. Harbottle*, 2 Hare 461, 67 Eng. Rep. 189 (1843).

⁸ *Whitten v. Dabney*, 171 Cal. 621, 154 P. 312 (1915).

⁹ *Beling v. American Tobacco Co.*, 72 N. J. Eq. 32, 65 A. 725 (1907); *BALANTINE, CORPORATIONS*, § 186 (1927).

¹⁰ *Merrill v. National Bank of Jacksonville*, 173 U. S. 131, 19 S. Ct. 360 (1899); *Ticonic Nat. Bank v. Sprague*, 303 U. S. 406, 58 S. Ct. 612 (1938).