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CORPORATIONS - STOCKHOLDER'S DERIVATIVE SUIT - DIVERSITY OF CITIZENSHIP

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CORPORATIONS — STOCKHOLDER'S DERIVATIVE SUIT — DIVERSITY OF CITIZENSHIP — Plaintiff, a New York corporation, brought a stockholder's derivative suit, in federal court, against the American Tobacco Company, a New Jersey corporation, and its directors, the majority of whom were citizens of New York. There being no federal question involved, defendant moved to dismiss the complaint because there was no proper diversity of citizenship. Plaintiff argued that by the New York decisions the ultimate interests of the

defendant corporation and the plaintiff were identical, and that consequently the defendant corporation must be considered as the real plaintiff, thus supplying the necessary diversity of citizenship under the rule of *Erie R. R. v. Tompkins*.[1] *Held*, that even assuming the applicability of the *Tompkins* case, the New York decisions had no bearing on the arrangement of parties for the purpose of determining federal jurisdiction. Motion to dismiss granted. *J. R. A. Corp. v. Boylan*, (D. C. N. Y. 1939) 30 F. Supp. 393.

It is well established that, for the purpose of determining jurisdiction on the basis of diversity of citizenship, federal courts will arrange the parties of record according to their real interests in the particular controversy.[2] Equally fundamental is the principle that the plaintiff's cause of action, in a stockholder's derivative suit, depends upon a showing of injury to the corporation, and that any recoverable damages will inure to the benefit of the corporation.[3] Obviously, therefore, the interest of the corporation in the outcome of such a suit is the same as that of the plaintiff-stockholder. It does not follow, however, that the corporation will be regarded as a plaintiff for the satisfaction of the jurisdictional test. Rule 23(b) of the federal rules of procedure requires that the complaint set forth the plaintiff's attempts to secure action by the corporation, along with the reasons for his failure to obtain such action.[4] To meet this requirement, the plaintiff will show that the directors have refused to act, although requested, or that the corporation is in such hostile control as to render any request unavailing.[5] The immediate conflict of desires which is thus indicated is deemed sufficient reason for regarding the stockholder and the corporation as opposing parties in the suit.[6] That this is the view of the federal courts is undoubted; but the plaintiff, in the principal case, sought to avoid the effect of the federal de-

[1] 304 U. S. 64, 58 S. Ct. 817 (1938), noted in 36 MICH. L. REV. 1312 (1938).

[2] Removal Cases, 100 U. S. 457 (1879); Pacific R. R. v. Ketchum, 101 U. S. 289 (1879).

[3] Niles v. New York Central & Hudson River R. R., 176 N. Y. 119, 68 N. E. 142 (1903); Smith v. Lewis, 211 Cal. 294, 295 P. 37 (1930); Eriksson v. Boyum, 150 Minn. 192, 184 N. W. 961 (1921).

[4] Rules of Civil Procedure for the District Courts of the United States, Rule 23(b): "In an action brought to enforce a secondary right on the part of one or more shareholders . . . because the association refuses to enforce rights which may properly be asserted by it. . . . The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the . . . directors . . . such action as he desires, and the reasons for his failure to obtain such action, or the reasons for not making such effort." This rule is substantially the same as Rule 27 of the Federal Equity Rules of 1912.

[5] See 13 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 6008 (1932).

[6] Venner v. Great Northern Ry., 209 U. S. 24, 28 S. Ct. 328 (1907); Doctor v. Harrington, 196 U. S. 579, 25 S. Ct. 355 (1904); Richardson v. Blue Grass Mining Co., (D. C. Ky. 1939) 29 F. Supp. 658. But where there is no showing of disagreement between the plaintiff and the management of the corporation, the corporation will not be aligned adversely to the plaintiff. Hirsch v. Independent Steel Co. of America, (C. C. W. Va. 1911) 196 F. 104, appeal dismissed, sub nom. Hirsch v. Taylor, 225 U. S. 698, 32 S. Ct. 841 (1912). Likewise, where the corporation, though nominally a defendant, joins in the prayer of the bill, it will be considered as a plaintiff. Lindauer v. Compania Palomas de Terrenos y Garnados, (C. C. A. 8th, 1917) 247 F. 428.

cisions, by invoking the rule of the *Tompkins* case and thus applying the principles of the New York decisions relative to stockholders' suits. Since the decision in the *Tompkins* case, to the effect that federal courts will apply the substantive law [7] of the states, the task of distinguishing substance from procedure has become of considerable importance. Although there are instances where the distinction is not clear,[8] the principal case would not seem to offer any difficulties in this respect. The determination whether or not there is diversity of citizenship in a particular case is a problem peculiar to the federal courts; and the rules which those courts employ in its solution seem plainly to be of a procedural nature. Since the state courts are not called upon to align parties for the ascertainment of diversity of citizenship, there necessarily can be no state adjudications as to the interests of the corporation and the stockholder for the purpose of such alignment.[9] The state decisions as to the interest of the corporation for an entirely different purpose—such as the recovery of damages—would not be applicable to the jurisdictional question confronting the federal courts.[10] Thus, the court, in the principal case, is able to decide contrary to the plaintiff's contention, even while proceeding on the hypothetical assumption that the New York decisions are controlling. It is submitted that the court's reasoning is sound and that its decision is justified. *Edward S. Biggar*

[7] The Tompkins case does not affect federal power over procedure in the federal courts. See Reed, J., in Erie R. R. v. Tompkins, 304 U. S. 64 at 92, 58 S. Ct. 817 (1938).

[8] Summers v. Hearst, (D. C. N. Y. 1938) 23 F. Supp. 986, noted in 37 MICH. L. REV. 654 (1939). See, generally, Cook, " 'Substance' and 'Procedure' in the Conflict of Laws," 42 YALE L. J. 333 (1933).

[9] The New York decisions, referred to by the plaintiff, merely state the well-recognized proposition that the right of action belongs to the corporation, so that the damages will redound to it. Niles v. N. Y. Central & Hudson River R. R., 176 N. Y. 119, 68 N. E. 142 (1903); Flynn v. Brooklyn City R. R., 158 N. Y. 493, 53 N. E. 520 (1899).

[10] Harris v. Brown, (D. C. Ky. 1925) 6 F. (2d) 922.