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Member of the New York bar

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STOCKHOLDERS' SUITS: A POSSIBLE SUBSTITUTE

Harris Berlack*

WITH the rapid expansion in the use of the corporate form of organization for business enterprise which has taken place during the last few decades, increasing attention has been paid by legal scholars to the question of the respective positions, rights and duties of the various components of the corporate structure. The functions, rights, obligations and liabilities of managers, officers, directors and stockholders, both majority and minority, have been analyzed and defined. Mr. Berle's analysis¹ of corporate authority as power held in trust for the benefit of the stockholders has found wide acceptance² as a comprehensive synthesis of the conclusions to be drawn from the numerous decisions of the courts. The relative positions of majority and minority stockholders have received extensive discussion, and the fiduciary relationship of the majority to the minority has been established and delimited.³ The stockholder, and especially the minority stockholder, has been the particular object of the solicitude of courts and legal thinkers; the most earnest concern of corporation law has been to establish and define his rights.

Much less attention, however, has been paid to the methods by which the rights of the stockholder may be enforced. In general, the result of the most liberal consideration of the stockholder's position and rights has been to consign him to the protection of a court of equity.⁴ That court has been found to be the most desirable forum for the adjudication of the issues which involve his rights, and in that court his proper procedure is a representative action on behalf of himself and all other stockholders. Thus the stockholder's only effective weapon for the enforcement of rights or the redress of wrongs is the "stockholders' suit."

*Member of the New York bar; S.B., LL.B., Harvard. Author of articles in various legal periodicals.—Ed.


² But see Dodd, "For Whom Are Corporate Managers Trustees?" 45 Harv. L. Rev. 1145 (1932).


The stockholders' suit here referred to is one in which a stockholder, acting on behalf of himself and all other stockholders, asks a court of equity to enforce a right which belongs to the corporation as such, but which the corporation has failed or refused to enforce, to the detriment of its stockholders. It is defined in Federal Equity Rule 27 as a "bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation." Judgment in such an action runs in favor of the corporation. The typical case occurs where the refusal of the corporation to act proceeds from the fact that the persons against whom the right is asserted are in control of the corporation itself; as, for instance, where an accounting for secret profits is sought from the dominant members of the board of directors. This type of proceeding is to be distinguished from one in which the plaintiff seeks a judgment in his own favor, instead of a judgment in favor of the corporation. Although his cause of action may have arisen out of the transaction whereby he acquired the stock, or out of other circumstances dependent upon the fact that he owns the stock, in seeking personal recovery he acts in his individual rather than in his stockholding capacity—as an individual party to a contract or as the individual victim of a tortious injury. In the true stockholders' suit, whereby the wrongs of stockholders as such may be righted, the plaintiff is merely an instigator, moving the court to action in behalf of the corporation. In the technical language of the books, the action is "derivative" as well as "representative."

This type of proceeding is of comparatively recent origin, but it has developed rapidly. The right to the maintenance of a derivative action by a single stockholder on behalf of all stockholders and for the benefit of the corporation, was first clearly recognized in England in 1843. In 1855, we find the Supreme Court of the United States saying that the jurisdiction of courts of equity to entertain such actions "is now no longer doubted, either in England or the United States." By 1881 the Supreme Court had recognized the increasing frequency of stockholders' suits, and had defined and regulated them substantially in the manner subsequently incorporated into the Equity Rules of 1912. It is interesting to read Justice Miller's pat on the shoulder of the infant procedure, which was later to become the scourge of courts and counting houses (104 U. S. 450 at 453): "That

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6 Dodge v. Woolsey, 18 How. (59 U. S.) 331 at 341, 15 L. Ed. 401 (1856).
7 Hawes v. Oakland, 104 U. S. 450, 26 L. Ed. 827 (1881).
increasingly prevalent in all of the American jurisdictions—an accom­
paniment to the expansion of corporate dominion over the economic
empire.

It is not the purpose of this article to trace the history of the stock­
holders’ suit, or to discuss its present technical details. Suffice to say
that it is now firmly established and of frequent occurrence in all
American courts of equity. With wide variations in procedure and in
scope, it is nevertheless fundamentally the same in all jurisdictions.
And whatever differences may exist, one common characteristic is
undeniably present wherever and whenever such an action is instituted:
the stockholders’ suit is universally reviled and deplored. Both those
who must bring them and those who must suffer them almost invari­
ably deprecate the necessity for the employment of this form of action,
and regret the lack of a more effective and at the same time less
bludgeon-like procedure.

Although the problem has received some discussion in legal period­
icals, and some of the objections to the stockholders’ suit have been
enumerated,8 there does not seem to have been any attempt at a com­
prehensive evaluation of the proceeding and its deficiencies as the basis
for an effort to conceive an adequate and less objectionable substitute.

To compile a complete catalogue of the iniquities ascribed to stock­
holders’ suits would, perhaps, be impossible. Most of the objections
raised are practical rather than legalistic, and they vary in detail and
emphasis from one case to another. It should be possible, however, to
enumerate and analyze the major objections,9 and to consider the

the vast and increasing proportion of the active business of modern life which is done
by corporations should call into exercise the beneficient powers and flexible methods
of courts of equity, is neither to be wondered at nor regretted; and this is especially
true of controversies growing out of the relations between the stockholder and the
corporation of which he is a member. The exercise of this power in protecting the
stockholder against the frauds of the governing body of directors or trustees, and in
preventing their exercise, in the name of the corporation, of powers which are outside
their charters or articles of association, has been frequent, and is most beneficial, and
is undisputed. . . .”

8 See Glenn, “The Stockholders’ Suit—Corporate and Individual Grievances,”
33 Yale L. J. 580 (1924); Rohrl height, “Suits in Equity by Minority Stockholders
as a Means of Corporate Control,” 81 Univ. Pa. L. Rev. 692 (1933); Rohrl height, Law
and Practice in Corporate Control (1933).

9 I cannot agree with Dean Pound when he says: “There is no need to recite
the difficulties involved in stockholders’ suits for mismanagement.” Pound, “Visitatorial
Jurisdiction Over Corporations in Equity,” 49 Harv. L. Rev. 369 at 395 (1936).
But I, do most emphatically agree with his comments which follow that just quoted:
“These suits have been abused quite as much as the powers of directors they have
intended to restrain. Indeed, these suits have been rendered relatively ineffective
feasibility of eliminating them by revising the procedure or by devising other methods for the enforcement of stockholders' rights.

THE PRESENT EVILS

Several of the complaints against the stockholders' suit are not peculiar to that type of litigation, but are applicable to litigation in general. Thus the objection to delay is not a special problem of litigation for the adjustment of corporate conflicts; delay in the ultimate adjudication of all complicated questions of law and fact is a general condition of our judicial system. Then the complaint that our courts are not competent to judge involved questions of corporate manipulation and business procedure is properly addressed to the consideration of general jurisprudence. The courts are no less competent to determine the liability of a delinquent director than they are to establish and enforce the responsibility of an agent, an executor, a trustee, or any other fiduciary. The questions involved are no more complex and require no greater familiarity with business affairs than is the case with hundreds of other situations daily adjudicated by the courts. The only solution applicable to these difficulties, aside from a general improvement in the judicial systems of the country, would be the removal of this type of controversy from the field of judicial determination—a proposal to be considered below.¹⁰

So, too, the objection that the applicable rules of law are vague and indefinite, and that the repositories of corporate authority cannot determine the rightness of their own conduct until it has been subjected to review by the courts, is not apposite to a discussion of this instance of judicial control alone. The principles to be applied are defined clearly enough; their application to particular states of fact always presents, of necessity, a justiciable question. Any argument in favor of more specific legislative definition of rights and liabilities in corporate affairs must be an argument in favor of the codification of all branches of the law similarly dependent upon equitable principles. This is a general problem of substantive corporation law which does not materially affect the questions of methodology under discussion here. Separate consideration of that problem, however, will probably lead to the limitations necessary to prevent abuse of them." To correct these abuses, one must understand exactly what they are. We all know that a mad dog is a dangerous animal; but Pasteur had to dissect a good many of them before he discovered the cure for rabies.

¹⁰ Infra, p. 607 ff.
conclusion that too rigid definition will be likely to impose greater hardships than the uncertainty of judicial review—and will produce no less litigation.\footnote{11}{"Statutes can do little more than indicate broad policies, and if too minute in detail their inflexibility would undoubtedly hinder more than aid. After all, where there are intricate relationships between various groups in a corporation, it is desirable that the flexible workings of courts of equity be retained and enlarged." Lattin, "The Minority Stockholder and Intra-Corporate Conflict," 17 IOWA L. REV. 313 at 331 (1932).}

Coming now to the difficulties which appertain especially to stockholders' suits, there is, first, the problem of expense. All litigation is expensive, to be sure, but stockholders' suits are exceptionally so. Because of the scope and complexity of the state of facts usually involved, and the number and closeness of the legal questions which arise, the labors of counsel are necessarily long and arduous. Extensive investigation to establish details of fact must be conducted; accountants and special investigators must be employed. Books and documents must be assembled, examined and copied; examinations must be conducted before trial wherever possible and the stenographic minutes transcribed and filed; witnesses must be interviewed, often in distant places, and foreign depositions may be necessary; the expense of assembling the evidence is, alone, usually enormous. The trial is often a long-winded proceeding; if witnesses must be brought from a distance and kept in attendance, their expenses mount; the employment of expert witnesses, too, is not infrequently necessary. The side which loses and desires to take one or more appeals faces a tremendous outlay, perhaps running into thousands of dollars, for the printing of records and briefs; and even the cost of preparing a comprehensive brief for the respondent on the appeal is far from negligible.\footnote{12}{"It is all very well to say that the minority stockholder has his redress if his company is being managed in an adverse interest. He hasn't—litigating against one of these powerful systems is an expensive business. The pitfalls and delays are endless. It is a luxury reserved for the large holders and then only when they have plenty of money and infinite patience." Samuel Untermyer, "Some Needed Legislative Reforms in Corporate Management," address to New York County Lawyers' Assn., January 5, 1911, quoted in Rohrlich, "Suits in Equity as a Means of Corporate Control," 81 UNIV. PA L. REV. 692 at 713, note (1933).}

The problem of expense is not confined to the stockholder; a heavy burden falls upon the corporation and the other defendants as well. The corporation is a party defendant and must be represented; and while the rule is that the expenses of the individual defendants cannot be charged to the corporation,\footnote{13}{Godley v. Crandall & Godley Co., 153 App. Div. 697, 139 N. Y. S. 236} it is usually these very defendants who

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\[\text{\footnote{13}{Godley v. Crandall & Godley Co., 153 App. Div. 697, 139 N. Y. S. 236}}\]
are in control of the corporate treasury, and do not hesitate to call upon it, at least for the initial disbursement. How much may be recovered from them later is conjectural. The cost of defense is quite as great as the cost of prosecution, and often greater; attorneys for large and vulnerable corporations do not work for pittances. But from the point of view of the defense, there is the saving fact that the corporate treasury usually is supplied with enough cash to meet the exigencies of the situation.

From the point of view of a minority stockholder, however, this problem of expense often presents an insuperable obstacle. Unless he is the owner of a substantial percentage of the minority shares, the financial return to him must necessarily be relatively small. If a judgment is recovered, its proceeds go into the treasury of the corporation; the resultant increase in the value of the shares of any particular small stockholder approaches the infinitesimal. The prospective reward is frequently too small to induce a stockholder, even if he has the means, to risk a heavy outlay on what may be a losing venture. There is, of course, the possibility of obtaining the support and contributions of other stockholders, but this is a laborious task and difficult of accomplishment. In the first place, it is practically impossible for an “outside” stockholder to obtain a complete list of the stockholders and their addresses. Many jurisdictions limit him to the right to examine the list only for a specified period before the annual meeting; in others, where the right is apparently broader, it is hedged round with practical obstacles. Even if a list be obtained, the expense and effort of circularizing and organizing the stockholders and persuading them to contribute to the cost of the campaign is almost as great as that of conduct-

(1912), modified 212 N. Y. 121, 105 N. E. 818 (1914); McConnell v. Combination Mining & Milling Co., 31 Mont. 563, 79 P. 248 (1905).


15 Thus the New York statute [N. Y. Stock Corporation Law, § 10; Laws 1923, c. 787, § 10, as amended by Laws 1933, c. 641, 58 N. Y. Consol. Laws (McKinney, Supp. 1936), § 10], which is as broad as any, provides that agent of 5 per cent of the stockholders, or any person who has been a stockholder for six months, is entitled to examine the stock books during three hours of any business day; but there is the proviso that the inspection “shall not be for the purpose of communicating with stockholders in the interest of a business or object other than the business of the corporation,” and that the person seeking inspection must not have sold or offered a stock list for sale or aided any person to obtain a stock list for the prohibited purpose, within the five years next preceding. The stockholder must not only identify himself, but must prove that he does not come within the excluded categories. In practice, any attempt to examine the stock list is treated with suspicion, and the stockholder must often resort to the courts to enforce his right of inspection.
ing the litigation itself. At times such efforts are themselves met by injunction proceedings before they are well under way, and the crusading stockholder has a battle on his hands before he is prepared to wage it.

As a consequence of this situation, we find that the conduct of the great majority of such cases is undertaken by attorneys on a contingent basis. The result is an increase in the expense of the proceeding. In making allowances to attorneys for the plaintiff in a successful litigation (to be paid by the corporation out of the proceeds of the judgment), the court takes into consideration the fact that the attorney took the chance of receiving nothing at all. The courts consider that he is entitled to compensation for that risk—a risk which impels many attorneys to avoid stockholders' suits. This is not to intimate that all contingent retainers are objectionable as such; they are often accepted by attorneys of integrity and ability. In the sort of case under consideration, however, the labor involved is so great and the outcome so uncertain that the leaders of the bar are seldom inclined to take the gamble. This leaves the field to the younger and less experienced or to the less successful and sometimes less scrupulous members of the profession. Plaintiffs, as a consequence, find it difficult to obtain proper representation; and defendants must oppose tactics which are not always the most ethical, or, at the least, are subjected to an attack which is unnecessarily and unpleasantly belligerent.

But even though the stockholder be able to obtain the services of the finest legal talent, counsel will find the conduct of the case a difficult task. Ordinarily the only complete and accurate sources of information on the matter are the corporate records, and they are within the control of the defendants. The suit is based in the beginning on scraps of information—the minimum of data which the corporation makes public, items which may turn up here and there in the files of others with whom the corporation has done business, and the trickles of mingled fact and rumor which may filter out through unguarded channels. All these may be pieced together to erect the framework of a complaint which states a good cause of action. At the trial, however, the interstices must be filled in, the details of construction supplied and

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16 In a recent case in New York, counsel expressed this reason in support of an application for a substantial allowance. The court awarded to the plaintiff's attorneys, for fees and expenses, 25 per cent of the amount recovered for the benefit of the corporation. Since the recovery was in the neighborhood of $1,700,000, the total allowance was over $400,000. Gallin v. National City Bank, (N. Y. Sup. Ct.) N. Y. L. J., Aug. 1, 1935, p. 332, col. 7.
roofed over, and a completed structure presented—with all the usual ornamentation. Unless a disgruntled employee or an uninhibited officer is willing to talk and act, or unless some other unusual source of information is available, this result can be accomplished only through the course of interrogatories and examinations and depositions before trial and discovery and inspection of the corporate books. The procedural facilities for this purpose are, of course, much more extensive in some jurisdictions than in others; but in all of them the procedure is so restricted and limited and “safeguarded” at every turn as to make it practically impossible to obtain a complete and true picture of the events and circumstances which produced the situation complained of. There is no need to discuss the technicalities. The major difficulty is that in legal theory the inspection must be kept within the bounds of a complaint which, as a practical matter, it is necessary to supplement by the inspection itself.\footnote{The cases where an examination is granted for the purpose of framing a complaint are extremely rare. In New York, for instance, it has been held that if the facts alleged in the moving affidavits show the existence of a good cause of action, an examination to frame a complaint is unnecessary. De Martini v. McCaldin, 176 App. Div. 541, 163 N. Y. S. 484 (1917). Whereas, on the other hand, the examination will be denied if the moving affidavits contain “no proof that the plaintiff has any cause of action.” Mitchell v. Central Mines Development Co., 124 App. Div. 325 at 327, 108 N. Y. S. 953 (1908). In the few cases which fall in the nebulous middle ground between these decisions, the examination is, as a matter of practice, strictly limited to proof of the cause of action indicated in the moving papers.}

An alternative to this state of affairs would be to grant an unlimited right of inspection upon the application of any stockholder; but this is what the courts call a “fishing expedition” and condemn. From the point of view of the corporation, the condemnation is fully justified. As it is, the harassment of unjust or unfounded suits is a serious burden to the corporation; to lay its books and affairs wide open and permit its offices to be invaded at will by any stockholder who has a real or fancied grievance, might unduly hamper the conduct of its business. Furthermore, this would be a dangerous weapon to put into the hands of the unscrupulous stockholder seeking a pretext for the institution of a “strike suit.”

For strike suits and the threat of them constitute the most serious objection to stockholders’ suits on the part of corporations and their officers and directors. There are individuals in plenty who will seize upon any slight irregularity as the basis for a charge of fraud, capture any wisp of smoke and attempt to fan it into flame, begin a stockholders’ action and set off the accompanying fireworks—and indicate,
tactfully or otherwise, that their stock may be purchased at a price, and
the suit withdrawn. Although there may be no basis whatsoever for
the action, these tactics may nevertheless be successful; the corporation
and the accused directors may find the cost and labor of defense more
burdensome than the price of settlement, or the publicity accompany­
ing a litigation more offensive than the unpleasantness of yielding to
groundless threats. But even where there are substantial grounds for
the charges and the threats carry the compulsion of possible execution,
if the stockholder is willing to “sell out” instead of pressing the advan­
tage for the benefit of the corporation, his actions are still classified
as strike tactics.18

For the abuse heaped upon the “strikers” there may be ample
justification. Unfortunately, those constantly affiliated with large cor­
porate interests have developed the habit of placing all complaining
stockholders in the same category. To the large corporation law offices
in the neighborhood of Wall Street or State Street or LaSalle Street,
every stockholders’ suit is ipso facto a strike suit. The name of the
litigious Venner, which appears in the captions of so many representa­
tive actions during the first two decades of the century, is a bugaboo to
frighten the fledgling corporation lawyer. So intensified has become the
rancor of this attitude, that the upstart who dares to question the conduct
of corporate affairs is cast outside the pale of common decency. The
opprobrium which may be heaped upon the plaintiff and counsel in a
stockholders’ action, by lawyers who have otherwise a reputation for
calmness, courtesy and fairness, would be unbelievable if so many
examples were not recorded in stenographers’ minutes and printed
briefs.19 For the reputable business man or lawyer to participate in
even the most thoroughly justified and socially praiseworthy of these
proceedings, is to bring down upon his head the violent wrath of the

18 “A ‘strike suit’ is 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 dis­
proportionate to the normal value of his interest as the price of discontinuance.” 34
Col. L. Rev. 1308 (1934).

19 The following from the brief in a recent New York case, is a fairly mild
sample: “This is a champertous, unlawful suit, which should not be countenanced by
this Court of Equity. The original plaintiff’s ... stock was put in his name by his
then attorneys for the sole purpose of instigating strike litigation. ... Plaintiff ... was also brought into this case by his lawyer, from whom he received all his informa­
tion. ... The case is patently one instituted and fostered by lawyers for the sole pur­
pose of getting a fee for themselves; it is of such unsavory origin that no Court of
Equity should entertain it. ... The plaintiffs in this case, holding trivial stock interests,
are obviously motivated solely by a sinister, self-seeking purpose.” For obvious reasons,
names are deleted and title and citation omitted.
financial gods and their legal prophets; especially if the plaintiff’s holdings are relatively small, there is no limit to their denunciation. The viciousness of such attacks militates against their very purpose; it insures that stockholders’ suits will be instituted and conducted, as a rule, only by those who are impervious to abuse—and hence capable of the most objectionable conduct. At the very least, it imbues the proceedings with a spirit of acrimonious bitterness, which is far from conducive to sober judicial determination of the issues. The case degenerates into an emotional conflict in which the court is eventually forced to take sides, to the detriment of calm reason and even-handed justice.

The catalogue is not yet complete. The suit may be instituted by a single individual, but it is for the benefit of all persons of the same class, and the decree binds them all; the issues litigated are res judicata. The case may be badly handled and lost, yet all the other stockholders are thenceforward out of court. It is even possible that the suit be brought by a friendly stockholder for the purpose of procuring an adjudication favorable to the defendants; unless the collusion can be affirmatively proved, there is no remedy. All suits by other stockholders will be barred or stayed until the determination of the first action instituted; but control of that action remains with the plaintiff. Unless other stockholders are joined as parties plaintiff, he conducts it as well or as badly as he chooses; he may permit it to linger or he may omit to tender or emphasize important evidence; he may even discontinue at will. If a suit which has been pending for a long time has been dismissed, or if it should develop that relief is barred by the ratification or acquiescence of the particular plaintiff or his predecessor in ownership of the stock, the statute of limitations may


23 Hirshfield v. Fitzgerald, 157 N. Y. 166, 51 N. E. 997 (1898); Bernheim v. Wallace, 186 Ky. 459, 217 S. W. 916 (1920); Allied Chemical & Dye Corp. v. Steel & Tube Co. of America, 14 Del. Ch. 368, 127 A. 414 (1925).
have run, and the other stockholders may thus be deprived of the right to proceed.

As a consequence of all this, a stockholder who is sincerely desirous of protecting his rights must be impelled to join in the proceeding. Any stockholder situated similarly to the plaintiff is entitled to intervene and be made a party plaintiff, and to participate in the conduct of the case; if the original plaintiff drops out, the intervening plaintiffs may nevertheless carry on. But this opens up another wide avenue of trouble. It means that in any case which attracts any considerable attention, there may be a host of plaintiffs and a horde of counsel whose temperaments and ideas may be in devastating conflict. There is the possibility that a stockholder in league with the defendants may intervene with the deliberate purpose of wrecking the proceeding. There is the temptation to lawyers to "chisel in" on a good case at the last minute and obtain a share of the allowances merely for appearance at the trial. The New York Supreme Court has recently worked out an ingenious solution whereby the latecomer is granted leave to intervene, so that the case may not be discontinued without his consent, but he is not permitted representation by additional counsel. But this procedure has not yet stood the test of appeal, and it does not seem entirely fair to the meritorious stockholder who is honestly dissatisfied with the previous conduct of the case; it is not a complete solution of the difficulty.

THE OBJECTIONS TO ADMINISTRATIVE JUSTICE

Possibly more might be added to the calendar of woe; but enough has been shown to permit a summary conclusion to be drawn and to indicate a possible solution of the problem. It would seem apparent that the major evils of stockholders' suits may be traced to the fact that they are proceedings which must be privately instituted and privately conducted by one person for the benefit of a class in whom he has, as individuals, no pecuniary interest—a proceeding in which there can be no honest financial reward commensurate with the initiative and effort required. The purpose of the stockholders' suit, one court has said, is the "prevention of a public wrong rather than the enforcement

of a private right." 27 This is not strictly true, but it contains an important element of truth. It is not the object of a stockholders' suit to compel the fulfillment of any obligation which corporate management owes to society as a whole—to the aggregated public. The rights which a stockholder seeks to enforce are his rights as a private owner of capital investments. But stockholders are many in number, and constitute a substantial portion of the entire public; in that sense the prevention of a wrong inflicted upon them is the prevention of a public wrong. Why, then, should it not be a public function?

A function of what public body? To place the affairs of corporations entirely under the control of a Bureau of Corporations or a Corporation Commission or any other so-called administrative agency, would immediately raise the usual cries of bureaucracy, paternalism, regimentation, socialism, etc. Touching as it would a vital spot in the economic order, it would stimulate with renewed intensity the controversy over administrative regulation and the "rule of law." But apart from these largely emotional reactions, it is important to determine whether this device would accomplish the desired purpose.

It is well to keep in mind that what we are considering here is a method for the enforcement of stockholders' rights—for exercising control over management in the interests of ownership. This necessarily presupposes the continued existence of an economic order embracing the private ownership of capital aggregated in the corporate form. It excludes, furthermore, a discussion of the means of diverting the benefits inherent in the corporate form of industrial organization to the uses of society. However desirable that aim may be, and however worthy of earnest consideration, it is not an end immediately attainable. That the theoretically most desirable social and economic conditions cannot be presently achieved should not preclude efforts toward the betterment of the existing system. 28 Nevertheless, in the

27 Gallagher v. Asphalt Co. of America, 67 N. J. Eq. 44, at 444, 58 A. 403 (1904).

28 "Now I submit that you can not abandon emphasis on 'the view that business corporations exist for the sole purpose of making profits for their stockholders' until such times as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else. . . . Most students of corporation finance dream of a time when corporate administration will be held to a high degree of required responsibility—a responsibility conceived not merely in terms of stockholders' rights, but in terms of economic government satisfying the respective needs of investors, workers, customers, and the aggregated community. . . . Meanwhile, as lawyers, we had best be protecting the interests we know, being no less swift to provide for the new interests as they successively appear." Berle, "For Whom Corporate Managers Are Trustees: A Note," 45 Harv. L. Rev. 1365 (1932).
establishment of agencies or methods for the latter purpose, it would not be unwise to have some regard for the ultimate social purposes to which these agencies and methods may in time be devoted.

From this point of view, then, how will an agency of administrative control work? To escape constitutional as well as popular condemnation, it must adopt rules of procedure which will insure a fair hearing to all parties; it must hear evidence and argument and it must render decisions which will be regarded as precedents, establishing standards for the administration of the law under which it operates. Its conclusions must be subject to ultimate judicial review, at least upon questions of legal interpretation, and in American experience that means an almost unlimited right of appeal to the courts. Presentation of evidence and arguments, the conduct of appeals, require protagonist and antagonist, plaintiff and defendant. In the end, the administrative agency must function exactly like a court. 29

This “court” will differ from the ordinary civil court in two important respects. In the first place, it will be an expert court, comprised of those who are, or will rapidly become, specialists in corporate affairs. Constant immersement in problems of corporate conduct will imbue a point of view—a legal philosophy—exceptional to that branch of the law alone. Indeed, the major argument in favor of administrative tribunals relates to their ability, unfettered by common legal techniques, to study and appreciate the social evils which the legislation creating them was intended to remedy, and to adopt attitudes favorable to the furtherance of the public policy thus expressed. 30 But unless we are prepared to define the purposes and extent of social control over corporate enterprise, what philosophy will dominate the tribunal? Without standards established by legislation, it will have none other

29 "The distinction between courts, bureaus, and commissions becomes a matter of elaborate definition, instead of recognition of the fact that the difference between a judge sitting as court, and one sitting as a bureau, is simply the difference of our attitude toward him, reflected in his attitude toward himself. . . ." ARNOLD, THE SYMBOLS OF GOVERNMENT 29 (1935).

"Ironically enough, the annoying red tape of governmental bureaus is more often than not the result of the efforts of learned men to make them resemble judicial institutions." Ibid., p. 215.

"If we did not know it, legal history could teach us that no one may be trusted to dispense with rules but one who knows the rules thoroughly and knows how to apply them upon occasion. Hence time has always imposed a legal yoke upon executive justice and has turned administrative tribunals into ordinary courts." Pound, "Justice According to Law, II," 14 Col. L. Rev. 1 at 25 (1914).

than those already generated by the courts of equity. Until, therefore, we are prepared to go beyond the adjudication of conflicts between the private rights of stockholders as a group and the private rights of management as individuals, until we are prepared to define by legislation and enforce by administration the interest of the public as such in the form and substance of the economic organization of industry, it would seem that an administrative tribunal, in its capacity as a court, can accomplish no better or essentially different results than the regular courts of equity. 81

In another important respect, the board or commission will differ from the ordinary court. If it follows the familiar pattern of its kind, it will be implemented with a staff and facilities for independent investigation; it will be able to employ the power of subpoena to relieve the stockholder in a large measure of the burden of assembling evidence. But to do this it must enter the lists; the evidence assembled must be presented at the hearing by a subordinate or a representative of the commission. The commission must become both litigant and judge, and the inequalities of the situation insure that, in its capacity as litigant, it will almost necessarily be on the side of the stockholder. Either that or it must, in effect, prejudge the case against the stockholder and refuse to proceed at all. It is this seemingly dual character of the administrative body which has aroused the greatest opposition to "executive justice," 82 and in a situation like the one here considered, it may prove a serious objection.

Where a commission is charged with regulation directly in the public interest, and where the standards according to which such regulation is to be accomplished are prescribed by the legislature and interpreted by the courts, facilities for investigation and independent fact-finding may be a necessary adjunct of efficient administration. There is in that case no real duality; the commission, by every resource at

81 I do not intend any such sentimental apostrophe as that to the "sympathetic regard of the chancellor which, in the past, has been the means of stimulating an awareness of morals in the realm of intra-corporate conflict." Lattin, "The Minority Stockholder and Intra-Corporate Conflict," 17 Iowa L. Rev. 313 at 342 (1932). But it must be recognized that, where the difficulties of procedure have been overcome, despite the hindrance of impractical legalistic rationalization and over-spun moralistic theorizing, courts of equity have managed to strike a reasonably fair balance between management and ownership.

82 It forms a part, no doubt, of what Dean Pound calls "the unhappy features of executive justice as shown by 'experience."' Pound, "Visitatorial Jurisdiction Over Corporations in Equity," 49 Harv. L. Rev. 369 at 395 (1936). The objection is characteristic of his insistence upon "justice according to law." Pound, "Justice According to Law, II," 14 Col. L. Rev. 1 (1914).
its command, determines the facts which must condition its application of the law. The functioning of administrative machinery under such conditions is gradually finding general, though reluctant, acceptance. But when the issue lies between the private property rights of two groups of individuals, albeit one group represents a substantial segment of the public, a procedure of this sort somehow offends our sense of the judicial proprieties. We cling to ancient faiths; we hesitate to abandon the traditional idea of "trial by combat," with an "impartial" judge acting the part of arbitrating deity. To oust the ordinary courts of jurisdiction over a situation which is not yet ripe for the technique of administrative fact-finding would offend against the ideal of "justice according to law," without accomplishing a comparable practical result.

Without this facility for authoritative probing of the factual situation, without machinery for investigation superior to that available to the private litigant, the administrative tribunal offers little relief from the difficulties confronting the complaining stockholder. The burden of activating the forces of control, and of assembling and presenting the material upon which these forces must operate, would still rest upon the private individual. Might it not be possible, however, to obtain the advantages of this valuable element of the administrative process without taking the full step into the realm of administrative justice? It would seem feasible to accomplish this result by substituting an agency of the government in place of the individual stockholder as the party complainant in suits brought in equity for the relief ordinarily sought in stockholders' suits.

A Government Agency to Represent Stockholders

Dean Pound has suggested the invocation of the visitatorial power of courts of equity over corporations, at the suit of the attorney general, as a means of corporate control. In that connection, he has pointed, as a possible example, to the provisions of the New York law granting to the attorney general the power to institute actions for the relief obtainable in a stockholders' suit. Other writers have referred to this statute in the same connection. In practical operation, however, the statute has proved to be a dead letter. As interpreted

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34 New York General Corporation Law, §§ 60, 61, 134; Laws 1909, c. 28, as generally amended by Laws 1929, c. 650, § 1, N. Y. Consol. Laws (McKinney 1929), §§ 60, 61, 134.
35 SAMUEL, SHAREHOLDERS' MONEY (1933); Douglas, "Director Who Do Not Direct," 47 HARV. L. REV. 1305 (1934).
by the attorney general and by the courts, the power may be invoked
only when some public interest is to be protected. 36 Employment of the
power lies entirely within the discretion of the attorney general, and
the courts will not review the exercise of his discretion. 37 During the
past decade, only three such actions have been instituted—in each case
for the removal of a director or officer, a proceeding which, under the
statute, can be instituted only by the attorney general. 38 Where appli­
cation has been made for the institution of an action, the attorney
general has adopted the practice of holding extended hearings to deter­
mine whether to act—a procedure almost as burdensome as the
conduct of the stockholders' suit itself. Since 1928, there have been
no applications for the exercise of the power. 39

What is required is a government official or agency specially
charged with the duty of prosecuting actions to protect the rights of
stockholders—perhaps an independent board or commission, possibly
a division of the justice department similar to the bureau organized by
the Attorney-General of New York to prosecute security frauds under
the Martin Act. Its principal attributes should be: that it have the
fullest powers of investigation, that it be charged with the duty of
investigating every complaint not obviously frivolous, that it be re­
quired to institute an action on behalf of the stockholders if the investi­
gation discloses a cause of action, and that it be vested with the exclusive
right to institute such actions.

It is important that the stockholder should not be required to
present evidence in support of his complaint; otherwise the new pro­
cedure would be little more helpful than the present New York Law.
All that should be required is that the complaint be not frivolous upon
its face; the stockholder must at least have something of which to
complain. If the governmental agency fail to act within a fixed period,
it should be required to show cause for the failure before the courts
upon a summary application by the complainant. Upon this applica­
tion, only the stockholder and the bureau should be heard; to permit
the corporation or the prospective defendants to appear would invite
a preliminary trial of the case on affidavits, and might lead to a habit
of permitting the parties to fight it out among themselves. The court

36 People v. Lowe, 117 N.Y. 175, 22 N.E. 1016 (1889); Swan v. Mutual Reserve
Rep. 59 (N. Y. 1919).
38 Attorney-General of New York, Annual Reports, 1924-1934 inclusive.
39 Information furnished to the writer by the Law Department of the State of
New York.
should be empowered to determine that a prima facie case exists, and to direct the bureau to institute an action; or it might decide that an investigation or further investigation is warranted, and direct that the bureau proceed accordingly; it could, upon a proper showing by the bureau, determine that adequate investigation has been made and that no facts have been revealed to justify the institution of an action; or it might dismiss the complaint as frivolous.

It is important, too, that the bureau's powers of investigation be unrestricted. It should have the power of subpoena, it should be entitled to the aid of the courts in obtaining access to all of the facts, and it should be provided with a sufficient staff of investigators, attorneys, accountants and clerical assistants to permit efficient exercise of its functions. Nor should its investigation be limited to the matter involved in the initial complaint. The state should be granted a fishing license denied to the private individual; the official character of the investigation should be sufficient guaranty against abuse. Indeed, there is no reason why the bureau should not be authorized to proceed on its own initiative. The extensive periodical reports, now required of many corporations by the federal laws governing the sale of securities and trading on security exchanges, would serve a most useful purpose if they were subjected to the scrutiny of an alert governmental agency charged with the duty of protecting the interests of stockholders.

But once the bureau has investigated and has declined to sue, once the courts have determined that no action is justified, that should be the end of the matter. The corporation and its officers should be subjected to no further harassment; the stockholder should not be permitted to gamble upon the possible results of a trial. The remedy provided should be exclusive.

An agency of the kind suggested, with powers and a procedure of the sort outlined, if properly devised and organized, should provide two great advantages, corresponding to the two greatest evils of stockholders' suits. It should relieve the individual stockholder of the necessity for investing his time, efforts and funds on behalf of other stockholders. To protect his own interests, he would need to do no more than make a formal complaint, or, in what should be the rare case, make a summary application to compel the controlling bureau to proceed. On the other hand, corporations and their managements would be fully protected against strike litigation. Once the complaint is made, there should be no possibility of settlement with the complainant; there should be no power to withdraw the complaint or to interfere with the conduct of the proceedings, any more than in the case
of a criminal complaint made to the district attorney. There would be no inducement to lawyers to accept contingent retainers; a moderate allowance might be made to a stockholder's attorney for a successful motion to compel the bureau to act, but there could be no hope of obtaining a substantial percentage of the amount recovered for the corporation. The cost both to the corporation and to its stockholders would thus be substantially reduced, at a comparatively small cost to the state. The one remaining opening for strike tactics—a demand for money or favored treatment upon the threat of filing a complaint—could be closed by treating such a demand or threat as blackmail, with the severe penalties usually imposed for that crime. In the end, both the power and the burdens of the stockholders' suit would devolve upon a responsible governmental agency, fully equipped to protect the interests entrusted to its care.40

In a recent paper,41 I expressed the opinion that the effective subjection of the corporate system of economic development to the interests of society as a whole is a major problem of modern social organization, and suggested the necessity for devising means to accomplish that end. The proposal made here is made in no small measure with the idea that it is a step in that direction. I do not delude myself into the belief that it is a very long step; it neither creates nor recognizes any new or greater obligation to the general public. It was devised as an immediately feasible means of overcoming defects in the machinery for enforcement of presently existing obligations, revealed by a practical analysis of the present system of judicial control. But if the proposal be adopted, and if the time should ever come for the law to impose upon corporate management those social responsibilities which exist now only as ideals, there will be at hand a group of experienced agencies which may readily be converted into effective instruments of social control.

40 I have proceeded upon the assumption that the proposed bureau would be a state rather than a federal agency. The possibility of establishing an effective nationwide agency of the kind suggested is to some extent a question of the feasibility of federal incorporation for interstate trading corporations, which I have discussed in a recent article. Berlack, "Federal Incorporation and Securities Regulation," 49 HARV. L. REV. 396 (1936). Even in the absence of such an extensive revolution in corporate organization, however, a similar federal agency might be created with authority to act in those cases where the federal courts would have jurisdiction over the stockholders' suit. That such an agency might be called upon to handle a large majority of all such cases is, perhaps, a reason to commend the idea.