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Corporations - Stockholders - Availability of Federal Remedy as Basis for Denial of Attorney Fees in Derivative Action

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CORPORATIONS—STOCKHOLDERS—AVAILABILITY OF FEDERAL REMEDY AS BASIS FOR DENIAL OF ATTORNEY FEES IN DERIVATIVE ACTION—Defendants were directors of Merritt, Chapman and Scott Corporation and of Montgomery Ward & Co., Inc. simultaneously. Plaintiff, a stockholder in Merritt, instituted a derivative suit to compel the resignation of defendants from their positions with Ward on the ground that an interlocking directorate existed making Merritt subject to criminal and civil prosecution under federal law.[1] Defendants resigned before judgment. Plaintiff, arguing that its suit was the cause of the resignations and that Merritt was thereby benefited, moved for an award of counsel fees to be assessed against Merritt. *Held,* application for counsel fee denied. Plaintiff could have achieved the results sought here by invoking the aid of the Federal Trade Commission without expense to the corporation.[2] *Schechtman v. Wolfson,* (S.D. N.Y. 1956) 141 F. Supp. 453.

Generally, where a stockholder can show that he has been successful in his derivative action with consequent benefit to the corporation, he will be entitled to be reimbursed by the corporation for reasonable counsel fees.[3] A monetary fund accruing to the corporation is clearly sufficient to meet the above requirement of benefit[4] but there is disagreement among the courts as to whether a non-fund benefit suffices.[5] There is authority to the effect

1 By federal law interlocking directorates having the effect of eliminating competition in violation of the antitrust laws are illegal. 38 Stat. 732 (1914), 15 U.S.C. (1952) §19.

2 "Whenever the Commission or Board vested with jurisdiction thereof shall have reason to believe that any person is violating or has violated any of the provisions of section . . . 19 of this title, it shall issue and serve upon such person and the Attorney General a complaint stating its charges. . . ." 38 Stat. 734 (1914), 15 U.S.C. (1952) §21.

"Any person, partnership, corporation, or association may apply to the Commission to institute a proceeding in respect to any violation of law over which the Commission has jurisdiction." Rule 4, Rules of Practice for the Federal Trade Commission, 38 Stat. 734 (1914), 15 U.S.C. (1952) §45.

3 Atwater v. Elkhorn, 184 App. Div. 253, affd. 227 N.Y. 611 (1919); Shaw v. Harding, 306 Mass. 441, 28 N.E. (2d) 467 (1940); Murphy v. North American, (S.D. N.Y. 1940) 33 F. Supp. 567.

4 Rogers v. Hill, (S.D. N.Y. 1941) 34 F. Supp. 358.

5 Shaw v. Harding, note 4 supra, expresses the view that only pecuniary benefit, embodied in a fund, will entitle stockholder to reimbursement. There are cases, however, which have allowed reimbursement where the benefit did not consist of a fund. See Hornstein, "The Counsel Fee in Stockholder's Derivative Suits," 39 COL. L. REV. 784 n. 99 (1939).

that entry of a judgment is not essential to the right to reimbursement,[6] although the cases which hold a fund deposited in court to be the only acceptable benefit would seem to require implicitly that the suit culminate in a judgment in favor of the stockholder.[7] The principal case, however, was obviously not decided by an application of the above test, for the ruling of the court would deny recovery without regard to whether or not the suit resulted in a benefit to the corporation.[8] The patent implication of the holding is that if a stockholder wants to preserve his right to a possible reimbursement, subject to compliance with the success-benefit criterion, he must show that prior to his own suit, he attempted to invoke all available gratuitous services of government agencies. Assuming that the stockholder in this case had complied with the court's recommended procedure, and that the Federal Trade Commission had taken proper action, a personal derivative suit would have been averted.[9] By a ruling directed at the stockholder's pocket-book, the court is encouraging the substitution of governmental remedies for the stockholder's suit. Such a rule will be welcomed by those who consider the merits of the stockholder's suit to be outweighed by its evils,[10] and even the advocates of the stockholder's suit may be satis-

[6] Greenough v. Coeur D'Alenes Lead Co., 52 Idaho 599, 18 P. (2d) 288 (1932). ". . . [T]he mere fact that he [stockholder] could not prove that he would have been entitled to a judgment . . . ought not to deprive him of reimbursement." Principal case at 455.

[7] To the effect that the success-benefit test is generally accepted, see Hornstein, "The Counsel Fee in Stockholder's Derivative Suits," 39 COL. L. REV. 784 (1939); BALLANTINE, CORPORATIONS, rev. ed., c. XI (1946); 152 A.L.R. 909 (1944).

[8] Principal case at 455.

[9] There is a possibility that the commission would not act upon a stockholder's submission of information. This is unlikely, however, in the present situation, i.e., where an interlocking directorate is involved, for the commission is empowered to institute proceedings on mere "good reason to believe" that an interlocking directorate exists. See note 2 supra. However, where other unfair trade practices are alleged to exist the commission must not only have "good reason to believe," but must decide that prosecution would be "in the interest of the public" before it can institute proceedings against the alleged violator. 38 Stat. 719 (1914), 15 U.S.C. (1952) §45 (b). In the latter situation the commission might well decide not to act for lack of public interest, even though the acts complained of would be sufficient basis for a stockholder's suit. In that case the stockholder, under rule of the principal case, having done his best to obtain gratuitous aid, could then proceed with a private suit without fear of being barred from reimbursement. In this latter situation the stockholder's suit is not eliminated, but would merely be delayed.

[10] See discussion in Berlack, "Stockholder's Suits: a Possible Substitute," 35 MICH. L. REV. 597 at 600 (1937), of the "present evils" of the stockholder's suit. Berlack suggests the establishment of governmental agencies or commissions which would have exclusive power to conduct litigation of matters which are now dealt with in stockholder's suits. Regardless of the steps taken by the agency, there would be no private suits allowed. Obviously, the Federal Trade Commission does not conform to this ideal insofar as a stockholder may bring a private suit regardless of whether the commission has been consulted on the matter, as is clear from the principal case. However, as a result of the holding in the principal case, the purpose of Berlack's system, namely, to prevent the bringing of private stockholders' suits, may be attained indirectly since the stockholder will very likely prefer to take his grievances to the Federal Trade Commission and rely on its remedial services, if it chooses to act, rather than ignore the agency, as in the principal case, and foot the bill of his private suit.

fied with this decision even though it discourages a personal and private assertion of rights.[11] Obviously, in the light of this holding, stockholders and their counsel would be well advised to investigate the possibilities of alternate remedial processes gratuitously offered by governmental agencies or bureaus before proceeding with a private action.

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11 That governmental action might be an acceptable substitute for the stockholder's suit has been suggested by Hornstein, a staunch advocate of the derivative suit. ". . . [U]ntil the stockholder's suit is supplemented with an effective preventive device, such as the application of criminal sanctions, the suit is society's principal safeguard." Hornstein, "The Counsel Fee in Stockholder's Derivative Suits," 39 COL. L. REV. 784 at 786 (1939). The Federal Trade Commission and other agencies like it, may, at least within a limited sphere of corporate abuse, provide "effective preventive devices" which would satisfy Hornstein.