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CONSTITUTIONAL LAW–DUE PROCESS–EQUAL PROTECTION OF THE LAWS–ANTI-"STRIKE SUIT" LEGISLATION HELD CONSTITUTIONAL

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CONSTITUTIONAL LAW—DUE PROCESS—EQUAL PROTECTION OF THE LAWS—ANTI-"STRIKE SUIT" LEGISLATION HELD CONSTITUTIONAL—Plaintiff brought a derivative suit against the defendant, a Delaware corporation, in a United States district court in New Jersey. While the suit was in process, New Jersey passed a statute permitting a corporation in whose name a suit was brought to demand security for reasonable expenses including attorney fees.[1] The plaintiff stockholder was to be liable for such expenses if the suit was unsuccessful. The statute was not to apply when the complainant's holding represented 5% of the par or stated value of the corporation's outstanding stock or had a value of $50,000. Since the act applied to suits in which no final judgment had been rendered, the defendant moved to require security. The district court ruled the statute not applicable to an action in the federal courts. After the circuit court reversed, the Supreme Court granted certiorari. *Held*, affirmed. Assuming that expenses can be secured only from the time the statute becomes effective, the statute is not unconstitutionally retroactive nor a denial of due process or equal protection of the laws. *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 69 S.Ct. 1221 (1949).[2]

Where the practical effect of legislation has been to deny access to the courts, the Supreme Court has held it unconstitutional as a deprivation of due process.[3] Imposing liability for attorney fees on the unsuccessful party is not in itself a denial of due process,[4] but such imposition will be invalid if resort to the courts is practically prohibited.[5] It is settled too that the equal protection clause is not a guarantee against discriminatory legislation, if the discrimination bears a direct and reasonable relation to an end which is legitimate.[6] Since costs and attorney fees generally will be prohibitive, even though reasonable, this statute will undoubtedly foreclose most minority stockholder suits in New Jersey regardless of their merit.[7] Its practical and substantial effect will be to deny access to the courts to stockholders who do not hold 5% or $50,000 worth of the corporation stock. Although this statute would seem, therefore, to present very grave problems of due process and equal protection, the Court did not find it necessary to consider

[1] N.J. Stat. Ann. (1946) tit. 14:3-15, added by N.J. Laws (1945) c. 131.

[2] In addition, the plaintiff objected that the order denying the motion was not a final judgment and not appealable, and that the statute was merely procedural and should not be applied by the federal courts. The court in the principal case decided against him on all points.

[3] Ex parte Young, 209 U.S. 123, 28 S.Ct. 441 (1908); Chicago and N.W. Ry. v. Nye Schneider Fowler Co., 260 U.S. 35, 43 S.Ct. 55 (1922); Wadley S. Ry. Co. v. Georgia, 235 U.S. 651, 35 S.Ct. 214 (1914); Oklahoma Operating Co. v. Love, 252 U.S. 331, 40 S.Ct. 338 (1919).

[4] Life & Cas. Ins. Co. v. McCray, 291 U.S. 566, 54 S.Ct. 482 (1933).

[5] Chicago & N.W. Ry. Co. v. Nye Schneider Fowler Co., supra, note 3.

[6] Quaker Cab Co. v. Pennsylvania, 277 U.S. 389, 48 S.Ct. 553 (1928); Frost v. Corporation Commission, 278 U.S. 515, 49 S.Ct. 235 (1929).

[7] See Shielcrawt v. Moffett, 49 N.Y.S. (2d) 64 (1944) where the cost was $113,000. Corporate expenses in the principal case will be increased by a provision in the corporate by-laws which require the corporation to indemnify its directors who are successful defendants in a derivative suit. See Beneficial Industrial Loan Corp. v. Smith, (C.C.A. 3d, 1948) 170 F. (2d) 44.

them at any length. The decision seems to be based squarely upon the fiduciary character of the stockholder's derivative suit. In the view of the Court, stockholders prosecuting such a suit act in a fiduciary capacity not technically as trustees but as representatives of other stockholder interests. Since litigation involving fiduciaries is peculiarly susceptible to control by the states and since corporations are creatures of the states, the states have plenary power over such corporate fiduciary litigation. It is becoming increasingly clear that stockholders in a derivative suit do act in a fiduciary or quasi-trust relationship. They can be held accountable to the corporation for the proceeds of a derivative action whether such proceeds are in the form of a judgment or a settlement.[8] The theory of the fiduciary character of the suit was developed primarily to curb unmeritorious suits;[9] it is now used to justify the virtual elimination of most derivative suits regardless of merit. Further, even though the states, as the principal case indicates, can close their courts to this type of litigation, they must still provide equal protection of the laws.[10] By treating the equal protection objection rather summarily in the principal case, the Court leaves the impression that equal protection, when a state has the power to eliminate a type of suit, is something different from a case where a state does not have such power. It is now clearly settled that the states may go ahead with this type of legislation.[11] Settled too is the fact that where such legislation is in force minority stockholders have virtually no feasible means to charge official misconduct in corporate affairs.

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[8] See Certain-Teed Products Co. v. Topping, (C.C.A. 2d, 1948) 171 F. (2d) 241, and Clark v. Greenberg, 296 N.Y. 146, 71 N.E. (2d) 443 (1947). Cf. Young v. Higbe Co., 324 U.S. 204, 65 S.Ct. 594 (1944), noted, 45 COL. L. REV. 625 (1945).

[9] See 24 N.Y. UNIV. L. Q. REV. 395 (1949) where repeal of a similar New York law is advocated. It is suggested that the New York rule requiring ownership of the stock at the time of the alleged wrong and at the time of suit, plus the trust character of the recovery proceeds would effectively bar strike suits.

[10] Southern R.R. Co. v. Greene, 216 U.S. 400, 30 S.Ct. 287 (1910). Power Manufacturing Co. v. Saunders, 274 U.S. 490, 47 S.Ct. 678 (1927).

[11] New York pioneered this type of legislation, N.Y. Gen. Corp. Law 61B. After conflicting opinions in the lower courts the New York Court of Appeals held the statute constitutional. Lapchak v. Baker, 298 N.Y. 89, 80 N.E. (2d) 751 (1948). For a history and criticism of the New York law, see Zlinkoff "The American Investor and the Constitutionality of Section 61B of the New York General Corporation Law," 54 YALE L.J. 352 (1945) and Hornstein, "The Death Knell of Stockholders Derivative Suits in New York," 32 CAL. L. REV. 123 (1944). For a discussion of the most recent state act, see Ballantine, "Abuses of Shareholders' Derivative Suits: How Far is California's New 'Securities for Expenses' Act Sound Regulation," 37 CALIF. L. REV. 399 (1949).