

1950

CORPORATIONS-STOCKHOLDER'S SUIT TO COMPEL DECLARATION OF DIVIDENDS- NECESSITY OF DIRECTORS AS PARTIES

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Recommended Citation

Daniel A. Isaacson S.Ed., *CORPORATIONS-STOCKHOLDER'S SUIT TO COMPEL DECLARATION OF DIVIDENDS- NECESSITY OF DIRECTORS AS PARTIES*, 49 MICH. L. REV. 275 ().

Available at: <https://repository.law.umich.edu/mlr/vol49/iss2/12>

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CORPORATIONS—STOCKHOLDER'S SUIT TO COMPEL DECLARATION OF DIVIDENDS—NECESSITY OF DIRECTORS AS PARTIES—Plaintiff, a citizen of New York and the owner of some preferred stock in the defendant Delaware corporation, brought a class action against the corporation in a federal district court in Pennsylvania to compel the declaration and payment of dividends on the preferred stock, alleging that the directors had acted in bad faith in violation of their duties as fiduciaries. Defendant's articles of incorporation provided that the preferred stock was entitled to receive dividends "when and as declared by the Board of Directors"; the by-laws permitted a majority of the board to constitute a quorum for purposes of transacting business. In an interlocutory order the court directed that a majority of the directors were necessary parties and should be served. Of the twelve directors, only the three who resided in Pennsylvania were served, there being no one state in which a majority could be served. On appeal from the granting of a motion to dismiss for lack of indispensable parties, *held*, reversed and remanded. In an action by a defrauded stockholder to compel the declaration and payment of dividends, the plaintiff has a cause of action against the corporation itself which can be enforced by a court of equity without the necessity of joining the directors, provided the corporation is properly made subject to suit and has property within the state. *Kroese v. General Steel Castings Corporation*, (3d Cir. 1950) 179 F (2d) 760.¹

¹ There appears to be a dispute on the question as to whether in federal courts all matters as to indispensable parties should be decided by reference to federal or state law.

While there has not been a great deal of litigation on this precise point, the case authority and text writers overwhelmingly expound the notion that in a class suit by shareholders to compel the declaration and payment of dividends, the directors are necessary parties.² Ordinarily, by virtue of state law or the articles of incorporation, the declaration of dividends is a matter solely within the discretion of the board of directors and a court of equity will not interfere with that internal management unless abuse of discretion or bad faith can be shown.³ The argument continues that since the court itself cannot declare a dividend but can only order the board of directors by an appropriate decree to do so, the directors, or a sufficient number to constitute a quorum, must be subject to the personal jurisdiction of the court in order that the decree be binding. On the surface this reasoning seems hard to attack for it would appear that no particular burden is placed upon the party bringing the action. However this problem assumes importance only in those situations where, for example, the requisite number of directors are not subject to service of process in any one jurisdiction, or, if they are, in a jurisdiction in which the corporation is not subject to suit.⁴ It is to this problem (where, under the above rule, a stockholder may have a right that is unenforceable in practice) that the principal case is directed in a real effort to achieve a fairer result. It being obvious that the plaintiff gains by a holding that directors are not necessary parties, the essential question is whether a measure of fairness to the corporation and its directors has been maintained, a question which this decision answers in the affirmative. This view starts from the idea that a stockholder, while he has no legal right to property of the corporation until a dividend is declared, has an equitable right under certain circumstances and therefore a cause of action exists against the corporation itself.⁵ Upon a proper showing, the court imposes a duty upon the corporate body⁶ to distribute the appropriate amount in dividends, leaving it to

CF. 3 MOORE, *FEDERAL PRACTICE*, 2d ed., 2153 (1948) with 3 OELINGER, *FEDERAL PRACTICE* 355 (1948). Judge Goodrich in writing this decision felt that in this context the question of indispensability was a matter of substance, depending upon state law. However, he added that the end result to this question should be the same regardless of the approach. Principal case at 761.

² *Schuckman v. Rubenstein*, (6th Cir. 1947) 164 F. (2d) 952, cert. den. 333 U.S. 875, 68 S.Ct. 905 (1948); *Kales v. Woodworth*, (6th Cir. 1929) 32 F. (2d) 37; *NY PA NJ Utilities Co. v. Public Service Commission*, (D.C. N.Y. 1938) 23 F. Supp. 313; *Connelly v. Weisfeld*, 142 N.J. Eq. 406, 59 A. (2d) 869 (1948); *Jones v. Van Heusen Charles Co.*, 230 App. Div. 694, 246 N.Y.S. 204 (1930); *Gesell v. Tomahawk Land Co.*, 184 Wis. 555, 200 N.W. 550 (1924). 11 FLETCHER, *CYC. CORP.*, perm. ed., §5326 (1931); BALLANTINE, *CORPORATIONS* §234 (1946).

³ 11 FLETCHER, *CYC. CORP.*, perm. ed., §5321 (1931).

⁴ Principal case at 765: "It would be most unjust if he could not prove that claim for the lack of a proper forum." This problem was recognized in 61 *HARV. L. REV.* 1253 (1948), a note criticizing the decision in *Schuckman v. Rubenstein*, supra note 2.

⁵ "It has been said that a shareholder's suit to enforce payment of a dividend to him and the others as individuals is 'derivative' and any suit he may bring should be as for a wrong to the corporation. This seems to be an erroneous theory. The right of shareholders to distributions of profits is a direct claim upon the corporation. . . ." BALLANTINE, *CORPORATIONS* §234 (1946). *Stevens v. United States Steel Corp.*, 68 N.J. Eq. 373, 59 A. 905 (1905).

⁶ 19 C.J.S., *Corporations*, §1287, p. 967 and §1304, p. 988 (1940).

the system of internal management to carry out legally the requisite declaration and payment. By virtue of their office and the obligations that flow therefrom the directors are bound to take the necessary steps to discharge this corporate legal duty.⁷ At best, the act of declaration that will be recorded on the minute book of the directors' meeting is a purely formal one, the court by hypothesis having already determined that the discretion and judgment of the directors in this matter is not controlling. As for the enforcement of the judgment, the court will proceed against the corporation and not the directors, resorting to traditional equity sanctions such as the sequestration of corporate property.⁸ In other words, the majority view looks on the ultimate duty of the directors to declare dividends as arising directly from the judgment, thereby necessitating personal jurisdiction over them, whereas the principal case considers the primary duty to be that of the corporation and the ultimate duty of the directors as only indirectly stemming from their official capacity.

Daniel A. Isaacson, S.Ed.

⁷ *Stevens v. United States Steel Corp.*, 68 N.J. Eq. 373 at 376, 59 A. 905 (1905): "When the final decree has established such a liability, it becomes the duty of the board of directors in office at the time when such decree is rendered to take such action as may be necessary in order that the corporation may perform the duty imposed upon it by the decree."

⁸ For an exhaustive study of the coercive process and equitable remedies available against a foreign corporation, see 10 FLETCHER, *CYC. CORP.*, perm. ed., c. 52 (1931).