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CORPORATIONS--STOCKHOLDERS' RIGHTS--MAJORITY DISCRETION AS BAR TO DERIVATIVE SUIT

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CORPORATIONS—STOCKHOLDERS' RIGHTS—MAJORITY DISCRETION AS BAR TO DERIVATIVE SUIT—Plaintiffs, minority stockholders of defendant corporation, brought an equitable action against certain directors thereof alleging the following wrongs: profits made by purchasing the corporation's notes at a discount; carrying out a plan to gain stock control; settlement of anti-trust suits out of court; excessive compensation of directors under management contracts alleged to violate anti-trust laws; paying excessive film rentals to another corporation. Plaintiffs unsuccessfully demanded that the board bring action against the directors on these grounds and then make a like demand at a stockholders' meeting. The stockholders voted not to sue, approved all actions alleged to be wrongs and instructed the board to reconsider the legality of the management contracts. The bill was dismissed by the Superior Court. On appeal, *held,* affirmed. The corporation's refusal, pursuant to a vote of a disinterested majority of stockholders, acting reasonably and in good faith, was valid and precluded the instant suit. *S. Solomont & Sons Trust, Inc. v. New England Theatres Operating Corporation,* (Mass. 1950) 93 N.E. (2d) 241.

As a general rule suits to redress corporate injuries must be brought by the corporation itself.[1] A derivative suit by a minority stockholder may be brought only after refusal by the board of directors to take action despite a proper demand upon them to do so. Some courts also require plaintiff in a derivative action to show a similar demand upon and refusal by the stockholders.[2] When the alleged wrongs are intra vires acts of directors,[3] unless these acts are fraudulent, in bad faith or a breach of trust, the courts will not interfere with what they call the internal management of the corporation even in an action by the majority of the stockholders.[4] Likewise they say that the preliminary decision by the board and/or stockholders whether or not to bring suit is also a matter of internal

[1] 18 C.J.S., §559 (1939); 13 FLETCHER, CYC. CORP. §5945 (1943).

[2] 18 C.J.S., §564 (1939); 13 FLETCHER, CYC. CORP. §§5961-5971 (1943); Hawes v. Oakland, 104 U.S. 450 (1881); Dunphy v. Traveller Newspaper Assn., 146 Mass 495, 16 N.E. 426 (1888).

[3] When the alleged wrongs are acts ultra vires, illegal or against public policy, which will result in waste, misapplication or diversion of corporate assets, refusal by the board of directors and majority stockholders to bring action will not bar action by the minority. 13 FLETCHER, CYC. CORP., §5823 (1943); BALLANTINE, CORPORATIONS §147 (1946).

[4] ". . . regardless of whether such acts are wise or expedient." 13 FLETCHER, CYC. CORP. 135 (1943); United Copper Securities Co. v. Amalgamated Copper Co., 244 U.S. 261, 37 S.Ct. 509 (1917).

management.[5] It would seem clear, however, that when the alleged wrongdoers themselves are, or control, the board and/or stockholders who decide that suit should not be brought, the action by the minority should not be barred if the alleged wrongful acts were fraudulent, in bad faith or a breach of trust.[6] The question which the court in the principal case had before it was whether a majority of stockholders, uncontrolled by the alleged wrongdoers and acting honestly and in good faith, should be allowed to bar the minority action even though the alleged wrongdoers are corporate officers and directors.[7] The court recognized that the expense, loss of time, danger of countersuits, and disturbance to successful business relationships which may be incident to a suit against third persons might as likely be present in suit against such officers and directors.[8] The result reached by this court would seem to be correct as long as the alleged wrongs were not acts beyond the powers of the corporation.[9] As Wilkins, J., speaking for the court in this case, said, "We know of no principle requiring that a corporation once wronged cannot exercise an honest judgment to refrain from doing that which may wrong it even more."[10] Though this case was decided in a state where demand on the board and the stockholders must be made before a derivative suit may be brought, it would seem to be equally good authority for the use of such a majority stockholders' decision as a bar to a derivative suit in states which require demand upon the board only.[11]

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[5] This means, of course, that the court will not interfere if that decision not to sue was made in good faith. 13 FLETCHER, Cyc. CORP. §5822 (1943); Kessler v. Ensley Co., (D.C. Ala. 1903) 123 F. 546. "The reasonable limit may well be whether the directors acted not only honestly but within the permissible bounds of an intelligent business judgment or discretion." BALLANTINE, CORPORATIONS 349 (1946); Groel v. United Electric Co. of N.J., 70 N.J. Eq. 616, 61 A. 1061 (1905). The usual statement to the effect that the stockholders cannot ratify fraudulent acts of directors would seem seriously to limit this rule in a minority derivative suit where the alleged wrongs are such fraudulent acts. As to this point see 53 HARV. L. REV. 1368 (1940).

[6] Brewer v. Boston Theatre, 104 Mass. 378 at 395 (1870); Von Arnim v. American Tube Works, 188 Mass. 515 at 518, 74 N.E. 680 (1905).

[7] Plaintiffs alleged that defendant directors controlled the board but there is no indication in the opinion as to whether defendants denied this or not. The court does not discuss the point. However, there would seem to be no need to discuss the efficacy of the stockholders' vote not to sue if an uncontrolled board had already made this decision.

[8] Principal case at 246.

[9] Supra note 3. The scant information in the opinion as to plaintiffs' allegations seem to indicate that none fall in the ultra vires, illegal or contra-public-policy class except for the allegation of illegality of the management contracts, as to which the stockholders instructed the board further to consider the question and thus there was not a sufficient "refusal." The language of the court is broad but its decision must, necessarily, be limited to the scope of the problem considered.

[10] Principal case at 249.

[11] The reasons for not requiring an application to the stockholders as a condition precedent to the derivative action seems to be the impracticality of such a requirement due to the delay thus involved, the size of modern corporations and the consequent difficulty and expense of getting the demand and arguments on both sides before the stockholders, and the general lack of power of the stockholders to give orders to the board. BALLANTINE, CORPORATIONS §146 (1946).