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CORPORATIONS-DERIVATIVE STOCKHOLDERS' SUITS-NEW YORK GENERAL CORPORATION LAW 61b

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CORPORATIONS—DERIVATIVE STOCKHOLDERS' SUITS—NEW YORK GENERAL CORPORATION LAW 61b—In a derivative stockholders' suit, the defendant corporation was granted an order for security for reasonable costs under the above statute¹ containing a provision that plaintiff stockholders might move to vacate the security order upon subsequent joinder of stockholders holding 5 per cent of the outstanding shares of any class of stock of the corporation or shares having a market value in excess of \$50,000. *Held*, two judges dissenting, order modified by deleting therefrom the provision for vacation. *Baker v. Macfadden Publications*, (App. Div. 1946) 59 N.Y.S. (2d) 841.

Under 61-b, a defendant corporation may require plaintiff stockholders, who do not own more than 5 per cent of any class of shares of the corporation or shares having a market value in excess of \$50,000, to secure the reasonable costs, including attorney fees, of any successful defendant, while plaintiffs who own the magical amount of stock neither secure nor pay the expenses.² The avowed purpose is to discourage "strike" suits; and, judging from the expensive legal talent with which stockholders' suits are defended, security for expenses is a threat well-calculated to achieve this purpose. The apparent effect is to stifle all derivative stockholders' suits since all are subject to the same burden. Whether, as in this statute, ownership of stock in the critical amount is an accurate test of the merit of a complaint leaves an engaging question.³ Abstractly, a meritorious derivative suit should not suffer a burden designed to deter "strike" suits, but can the inflexible statute be applied differentially? The trial court found room for discretion⁴ to grant a deserving plaintiff who was

¹ N.Y. Gen. Corp. Law (McKinney, Supp. 1946) §61-b.

² *Isensee v. Long Island Motion Picture Co., Inc.*, 184 Misc. 625, 54 N.Y.S. (2d) 556 (1945).

³ *Citron v. Mangel Stores Corporation*, (N.Y. S.Ct. 1944) 50 N.Y.S. (2d) 416. For a comprehensive treatment of section 61-b, its relation to other obstacles to a derivative suit, and some of the social consequences see: Jackson, "Reorganization of the Corporate Concept and the Effect of Section 61-b of the New York General Corporation Law," A⁵ CORP. REORG. & AM. BANK REV. 323 (1944); Hornstein, "The Death Knell of Stockholders' Derivative Suits in New York," 32 CAL. L. REV. 123 (1944); Zlinkoff, "The American Investor and the Constitutionality of Section 61-B of the New York General Corporation Law," 54 YALE L. J. 352 (1945); Carson, "Current Phases of Derivative Actions Against Directors," 40 MICH. L. REV. 1125 (1942).

⁴ Retroactive application of 61-b [N.Y. Gen. Corp. Law (McKinney, Supp. 1946) §61-b] tended to founder pending suits, so plaintiffs were granted a short time in which to bring themselves within the exception by joinder of the requisite stockholdings, action on the motion for security being delayed meanwhile. *Noel Associates, Inc., v. Merrill*, 184 Misc. 646, 53 N.Y.S. (2d) 143 (1944); *Shielcrawt v. Moffett* (N.Y. S.Ct. 1944) 49 N.Y.S. (2d) 64.

caught between 61-b and its formidable companion, a short statute of limitations,⁵ an opportunity to join an exempting stock representation. Perspective justifies a reversal of the vacation provision. The decision on the point is perfunctory, and the appellate division could not have been more than facetious when asking whether the right to security should be made to depend upon the fluctuations in the market value of a plaintiff's stockholdings during a trial, but sound reasons are implicit. The trial court's device would have relieved the pressure from a few meritorious plaintiffs, but only at an overwhelming sacrifice of trial convenience and economy. Moreover, relieving individual hardship with troublesome expedients is like easing a painful symptom of an illness with narcotics; the illness becomes less prominent while the virus entrenches. A more adequate and direct cure for arbitrary classification is to be found in the due process and equal protection language of the Constitution. Though the inclination is to hold 61-b constitutional, New York appellate courts have split,⁶ and the probabilities of the final outcome still are inconclusive. Were it finally held valid, resort to the legislature may be anticipated; and, this recourse failing, then perhaps the exercise of judicial ingenuity in the behalf of small stockholders will find itself more welcome.

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⁵ Stockholders' derivative suits must be brought within three or six years of the commission of the wrongful act; usually three years. New York Civil Practice Act (Cahill, Supp. 1945) 48, subd. 8; *id.* (Cahill, 1937) 49, subds. 6, 7.

⁶ The periodicals unanimously declare 61-b unconstitutional; New York courts differ. For validity: *Shielcrawt v. Moffet*, (N.Y. S.Ct. 1944) 49 N.Y.S. (2d) 64, affirmed, 268 App. Div. 352, 51 N.Y.S. (2d) 188 (1944), reversed on other grounds, 294 N.Y. 180, 61 N.E. (2d) 435 (1945);¹ *Wolf v. Atkinson*, 182 Misc. 675, 49 N.Y.S. (2d) 793 (1944); the principal case reaffirms the court's position in the *Shielcrawt* case. Cf. *Citron v. Mangell Stores Corporation*, (N.Y. S.Ct. 1944) 50 N.Y.S. (2d) 416, affirmed, 268 App. Div. 905, 51 N.Y.S. (2d) 754 (1944); 159 A.L.R. 978 (1945).