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Notes: Director's Statutory Action in New York

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NOTES

DIRECTOR'S STATUTORY ACTION IN NEW YORK

I

INTRODUCTION

The power and duty of managing the ordinary business of a corporation are vested in the board of directors¹ who are fiduciaries of the corporation.² The standard of care which the directors are required to exercise in supervising corporation affairs is the degree of care and skill which an ordinarily prudent director of a similar corporation would use in the same circumstances.³ For more than a century shareholders have used the derivative suit to hold directors accountable for any losses arising from breach of their fiduciary duty or failure to exercise due care.⁴ New York, by statute, also permits a director to maintain an action for directors' or officers' acts of misconduct.⁵

1. 1 Hornstein, *Corporation Law and Practice* § 431 (1959); Lattin, *Corporations* 211 (1959). Many states have statutes providing that the corporate business shall be managed by the board of directors. Lattin, *supra* at 214. See, e.g., N.Y. Gen. Corp. Law § 27 (Supp. 1960).

2. E.g., *Cohen v. Cocoline Prods. Inc.*, 309 N.Y. 119, 127 N.E.2d 906 (1955); *Sialkot Importing Corp. v. Berlin*, 295 N.Y. 482, 68 N.E.2d 501 (1946); *Bloom v. National United Benefit Sav. & Loan Co.*, 152 N.Y. 114, 46 N.E. 166 (1897).

3. This standard was formulated in *Briggs v. Spaulding*, 141 U.S. 132 (1891), in which the Supreme Court stated that the requisite degree of care is "that which ordinarily prudent and diligent men would exercise under similar circumstances, and in determining [the degree of care] . . . usages of business should be taken into account." *Id.* at 152. Professor Lattin states that the Briggs standard is the common expression for the duty of care required of directors. Lattin, *supra* note 1, at 241. Professor Hornstein, on the other hand, says that the prevailing standard is that of New York, i.e., the degree of care which ordinarily prudent men, acting in their own self-interest, would use in conducting their own affairs. 1 Hornstein, *supra* note 1, § 446. For an application of the New York standard, see *Hun v. Cary*, 82 N.Y. 65 (1880).

4. *Robinson v. Smith*, 3 Paige Ch. 222 (N.Y. 1832); *Taylor v. Miami Exporting Co.*, 5 Ohio 162 (1831); *Preston v. Grand Collier Dock Co.*, 11 Sim. 327, 59 Eng. Rep. 900 (Ch. 1840).

5. N.Y. Gen. Corp. Law § 60 (1943), § 61 (Supp. 1960). Section 60 reads as follows:

"An action may be brought against one or more of the directors or officers of a corporation to procure judgment for the following relief or any part thereof:

1. To compel the defendants to account for their official conduct, including any neglect of or failure to perform their duties, in the management and disposition of the funds and property, committed to their charge.

2. To compel them to pay to the corporation, or to its creditors, any money and the value of any property, which they have acquired to themselves, or transferred to others, or lost, or wasted, by or through any neglect of or failure to perform or other violation of their duties.

3. To suspend a defendant from exercising his office, for an abuse of his trust.

4. To remove a defendant from office and to direct the filling of the vacancy in accordance with the charter and by-laws of the corporation, or, if they contain no provision therefor, in such manner as the court shall direct.

5. To set aside a transfer of property, made by one or more directors or officers

The purpose of this Note is to (1) set forth and analyze the existing law on the director's statutory action, (2) show how it differs from the shareholders' derivative suit, (3) analyze the effect of the director's suit on the current problem of when a president of a corporation has implied authority to institute suit in the name of the corporation, and (4) point out the advantages which the director's action has over that of the shareholder.

II

THEORY OF SHAREHOLDERS' AND DIRECTOR'S ACTIONS

Shareholders' Derivative Action.—The shareholders' derivative suit was developed in equity to provide a means of correcting abuses by corporate management without a multiplicity of suits.⁶ When the corporation is injured by the directors' negligence or breach of duty, a corporate cause of

of a corporation, contrary to provision of law, where the transferee knew the purpose of the transfer.

6. To enjoin such a transfer where there is good reason to apprehend that it will be made."

The appointment of a receiver of the corporation's property can also be granted as part of the relief. The supreme court has inherent power to appoint a receiver of the property of a corporation. *Popper v. Supreme Council of the Order of Chosen Friends*, 61 App. Div. 405, 70 N.Y. Supp. 637 (2d Dep't 1901). This type of relief was granted in *Miller v. Barlow*, 78 App. Div. 331, 79 N.Y. Supp. 964 (1st Dep't 1903).

Section 61 provides in part: "An action may be brought for the relief prescribed in section sixty of this chapter, by the attorney-general in behalf of the people of the state, or except for the relief specified in the third and fourth subdivisions of said section by the corporation or a creditor, receiver or trustee in bankruptcy thereof, or by a director or officer of the corporation."

Sections 60-61 do not apply "to a religious corporation; to a municipal or public benefit corporation, created by the constitution or by or under the laws of this state; nor . . . to any corporation which the regents of the university have power to dissolve, except in aid of its liquidation under such dissolution, upon the application of the regents, or of the trustees of such a corporation." N.Y. Gen. Corp. Law § 130 (1943).

In New York, the director's action was first authorized in 1828. N.Y. Sess. Laws 1828, ch. 20, § 3 [codified in 2 Rev. Stat. pt. 3, ch. 8, tit. 4, §§ 33, 35 (1828)]. For a time the authorization was codified as N.Y. Code Civ. Proced. §§ 1781-82 (Banks & Bros. 1880). The predecessor sections of the current sections 60-61 were codified as N.Y. Gen. Corp. Law §§ 90-91 (1917). N.Y. Sess. Laws 1909, ch. 28. The old § 91 differed from § 61 in providing that the action could be maintained by an "officer . . . having a general superintendence of its concerns." Consequently, under § 91, the treasurer of a corporation could not maintain a suit since he was not an officer having general superintendence of its concerns. *Loughlin v. Wocker*, 152 App. Div. 466, 137 N.Y. Supp. 257 (2d Dep't 1912). Since this qualification does not appear in § 61, a treasurer is now allowed to bring suit. *Peets v. Manhasset Civil Eng'rs, Inc.*, 68 N.Y.S.2d 335 (Sup. Ct. 1946). For general legislative history, see *People v. Lowe*, 117 N.Y. 175, 22 N.E. 1016 (1889); *People v. Equitable Life Assur. Soc'y of the United States*, 124 App. Div. 714, 109 N.Y. Supp. 453 (1908).

Michigan is the only other state found to have legislation similar to New York's. Mich. Comp. Laws § 450.47 (1948). Alaska had a statute, Alaska Sess. Laws 1931, ch. 8, § 19, similar to New York's. It was repealed, however, in 1957. Alaska Sess. Laws 1957, ch. 126, § 156.

6. See *Brinckerhoff v. Bostwick*, 88 N.Y. 52 (1882); *Prunty, The Shareholders' Derivative Suit: Notes on its Derivation*, 32 N.Y.U.L. Rev. 980 (1957).

action arises.⁷ Historically, when a shareholder sued management to enforce the corporate cause of action, he did not pursue the corporate right to institute suit. Rather he exercised an equitable right belonging to the shareholders to enforce a duty owed them by the directors as a consequence of the power vested in the board.⁸ The modern theory is that the shareholders' suit for acts of managerial abuse is "secondary" or "derivative,"⁹ the primary right to bring suit belonging to the corporation.¹⁰ A shareholder is permitted to enforce the cause of action only because he has a proprietary interest in the corporation,¹¹ the value of which has declined as a result of the mismanagement.¹² Since the shareholder in instituting suit has no duty to other shareholders, his relation to them is merely that of a volunteer.¹³

These three characteristics of a derivative suit, (1) the secondary

7. *Isaac v. Marcus*, 258 N.Y. 257, 179 N.E. 487 (1932); *Greaves v. Gouge*, 69 N.Y. 154 (1877); *W. E. Hedger Transp. Corp. v. Ira S. Bushey & Sons*, 186 Misc. 758, 61 N.Y.S.2d 876 (Sup. Ct. 1945), *aff'd mem.*, 270 App. Div. 912, 61 N.Y.S.2d 882 (2d Dep't 1946); *Coronado Dev. Corp. v. Millikin*, 175 Misc. 1, 22 N.Y.S.2d 670 (Sup. Ct. 1940).

8. *Robinson v. Smith*, 3 Paige Ch. 222 (N.Y. 1832); *Taylor v. Miami Exporting Co.*, 5 Ohio 162 (1831); *Attorney-General v. Utica Ins. Co.*, 2 Johns. Ch. R. 371, 389-90 (N.Y. 1817) (dictum); *Prunty*, *supra* note 6, at 989, 994.

9. The "derivative" or "secondary" nature arose when the shareholders successfully extended their right to extracorporate defendants since such third parties are obligated only to the corporation and not to the shareholders. *Prunty*, *supra* note 6, at 989-92, 994. The demand requirement resulted from the recognition that the shareholders' rights were derivative. *Prunty*, *supra* note 6, at 991. Prior to 1840, the cases involving an action by a shareholder for managerial abuse did not require an allegation of demand nor did the complaints contain one. *Taylor v. Miami Exporting Co.*, *supra* note 8; *Preston v. Grand Collier Dock Co.*, 11 Sim. 327, 59 Eng. Rep. 900 (Ch. 1840). See *Attorney-General v. Utica Ins. Co.*, *supra* note 8, at 389-90. Cf. *Wells v. Jewett*, 11 How. Pr. 242, 247 (N.Y. Sup. Ct. 1855); *Robinson v. Smith*, *supra* note 8, at 232-33. One of the earliest cases requiring a demand upon the board of directors was *Vanderbilt v. Garrison*, 3 Abb. Pr. 361 (N.Y. Super. Ct. 1856). The case dealt with extracorporate defendants.

10. *W. E. Hedger Transp. Corp. v. Ira S. Bushey & Sons*, 186 Misc. 758, 61 N.Y.S.2d 876 (Sup. Ct. 1945), *aff'd mem.*, 270 App. Div. 912, 61 N.Y.S.2d 882 (2d Dep't 1946); *Isaac v. Marcus*, 258 N.Y. 257, 264, 179 N.E. 487, 489 (1932) (dictum).

11. "This right arises out of the interest the stockholders have in the preservation of the corporate property and the trust relation of the directors to them." *Bloom v. National United Benefit Sav. & Loan Co.*, 81 Hun 120, 123, 30 N.Y. Supp. 700, 702 (Sup. Ct. 1894), *aff'd*, 152 N.Y. 114, 46 N.E. 166 (1897). On appeal, the court in the *Bloom* case rejected the idea that directors are trustees of the shareholders. 152 N.Y. at 120, 46 N.E. at 167.

12. To protect the rights of creditors and avoid a multiplicity of suits, recoveries by individual shareholders are not allowed. Recoveries go to the corporation. *Niles v. New York Cent. & H.R.R.R.*, 176 N.Y. 119, 68 N.E. 142 (1903); *Ballantine, Corporations* § 143 (rev. ed. 1946). Tax considerations have also been cited as supporting recovery by the corporation rather than by stockholders. *Liken v. Shaffer*, 64 F. Supp. 432, 441 (N.D. Iowa 1946).

13. *Williams v. Robinson*, 9 Misc. 2d 774, 775, 169 N.Y.S.2d 811, 813 (Sup. Ct. 1957) (dictum), *aff'd mem. sub nom. Levy v. Whipple*, 5 App. Div. 2d 823, 170 N.Y.S.2d 991 (1st Dep't 1958).

nature of the right, (2) the protection of a proprietary interest and (3) the volunteer status of the shareholder, account for the differences between actions for managerial abuse brought by shareholders and those instituted by directors.

Director's Statutory Action.—Section 61 of the New York General Corporation Law expressly authorizes a director to institute an action to redress corporate wrongs caused by acts of misconduct of other directors or officers.¹⁴ Thus, the right is "original" and not "secondary" or "derivative" and the action should properly be called a director's statutory action. In pursuing his right under section 61, a director is not a volunteer. He is fulfilling his "stewardship obligation" to the corporation and the shareholders.¹⁵ In fact, it has been said that another reason for giving the director this right was to "protect him from possible liability for failure to proceed against those responsible for improper management of the corporate affairs."¹⁶ Thus, the basis of the director's suit is not any proprietary interest.¹⁷ Absent the statute, a director could not bring suit to recover for a corporate wrong in his capacity as director.¹⁸ Apparently, the reason would be that an action by an individual director would violate Section 27 of the General Corporation Law, which provides that the affairs of the corporation should be managed by the board.¹⁹

III

CONDITIONS PRECEDENT

Demand.—The primary right to redress wrongs to the corporation belongs to the corporation and not to its shareholders.²⁰ Therefore, a share-

14. N.Y. Gen. Corp. Law § 61 (Supp. 1960).

15. *Tenney v. Rosenthal*, 6 N.Y.2d 204, 211, 160 N.E.2d 463, 467, 189 N.Y.S.2d 158, 163 (1959).

16. *Id.* at 211, 160 N.E.2d at 467, 189 N.Y.S.2d at 163. This point is questionable. Absent a statute the director would not be able to institute suit. The court, however, may have assumed that prior to the statute a director's failure to inform the stockholders of a wrong, although he did not participate in it, constituted a breach of duty for which he could be held accountable. With the existence of a statute today, it is very likely that a director's failure to institute suit, when there is reason to believe that a wrong has been committed, would constitute a breach of duty. For language indicating this, see *Cohen v. Cocoline Prods., Inc.*, 309 N.Y. 119, 124, 127 N.E.2d 906, 908 (1955); *Schoenherr v. Van Meter*, 215 N.Y. 548, 552, 109 N.E. 625, 626 (1915) (*semble*). This rule would enable a wrong to be redressed if the statute of limitations had run against the wrongdoers but not against the director who later discovered the wrong and failed to take action.

17. In New York, a director may be relieved of the necessity for proprietary interest by the certificate of incorporation or by-laws. N.Y. Stock Corp. Law § 55 (1951). That most states do not require that a director be a shareholder, see *Lattin*, *supra* note 1, at 212.

18. See *Tenney v. Rosenthal*, 6 N.Y.2d 204, 211, 160 N.E.2d 463, 467, 189 N.Y.S.2d 158, 163 (1959).

19. N.Y. Gen. Corp. Law § 27 (Supp. 1960).

20. *W. E. Hedger Transp. Corp. v. Ira S. Bushey & Sons*, 186 Misc. 758, 61 N.Y.S.2d 876 (Sup. Ct. 1945), *aff'd mem.*, 270 App. Div. 912, 61 N.Y.S.2d 882 (2d Dep't 1946); *Isaac v. Marcus*, 258 N.Y. 257, 264, 179 N.E. 487, 489 (1932) (*dictum*).

holder must establish his right to sue either by alleging that he made a demand and refusal on the directors who wrongfully refused to take action or by setting forth facts which show that such a demand would have been futile.²¹ A demand and refusal are not required as a condition precedent to a director's action, since section 61 which expressly governs the action has no such requirement.²²

It is submitted that there should be a demand requirement for director's actions in order to give greater effect to section 27 which provides that corporate affairs are to be managed by the board.²³ Actions by a single director under section 61 would then be limited to situations in which the board of directors abused their discretion by wrongfully refusing to sue.²⁴

Contemporary Ownership Rule.—The plaintiff in a derivative action must show that he was a stockholder at the time the alleged wrong was committed²⁵ or that his stock thereafter devolved upon him by operation of law.²⁶ The contemporary ownership requirement must also be satisfied as a condition to intervention in such a suit.²⁷ Complaint may be made of a continuing wrong after acquisition of stock.²⁸ However, a complaint framed in the present tense will not circumvent the rule if the allegations refer back to the original wrong which occurred prior to plaintiff's ownership.²⁹ This provision applies to any shareholders' action to assert the corporation's right

21. *Koral v. Savory, Inc.*, 276 N.Y. 215, 11 N.E.2d 883 (1937); *Continental Sec. Co. v. Belmont*, 206 N.Y. 7, 99 N.E. 138 (1912). See discussion of the reason for the demand requirement in note 9 supra. Demand on the shareholders is also necessary where the act complained of is subject to ratification by the shareholders. *Continental Sec. Co. v. Belmont*, supra.

22. *Rabinowitz v. Schwartz* (Sup. Ct. 1954), in 131 N.Y.L.J. No. 6, p. 10, col. 5; *Katz v. Braz*, 188 Misc. 581, 66 N.Y.S.2d 722 (Sup. Ct. 1946), aff'd mem., 69 N.Y.S.2d 324 (1st Dep't 1947); *Miller v. Barlow*, 78 App. Div. 331, 336, 79 N.Y. Supp. 964, 968 (1st Dep't 1903) (dictum).

23. Cf. *West View Hills, Inc. v. Lizau Realty Corp.*, 6 N.Y.2d 344, 348, 160 N.E.2d 622, 625, 189 N.Y.S.2d 863, 866 (1959) (Froessel, J., dissenting). In light of the majority's apparent disinclination to read § 27 strictly, however, it is doubtful that the court of appeals would hold that demand in a director's action is necessary.

24. This statement presumes that the courts would treat the requirement of demand on the board in a director's suit just as they do in a shareholders' action, i.e., by permitting suit, absent a demand, upon a showing that demand would have been futile.

25. N.Y. Gen. Corp. Law § 61 (Supp. 1960). Before this statute was amended in 1944, no such rule existed in New York. See *Continental Sec. Co. v. Belmont*, 206 N.Y. 7, 99 N.E. 138 (1912). The provision is constitutional. *Coane v. American Distilling Co.*, 298 N.Y. 197, 81 N.E.2d 87 (1948); *Myer v. Myer*, 296 N.Y. 979, 73 N.E.2d 562 (1947) (mem.), affirming 271 App. Div. 465, 66 N.Y.S.2d 83 (1st Dep't 1946). The stock must be owned at the commencement of the action, as well as at the time of the wrong. *Miller v. Miller*, 256 App. Div. 846, 9 N.Y.S.2d 448 (2d Dep't) (mem.), aff'd mem., 280 N.Y. 716, 21 N.E.2d 212 (1939).

26. N.Y. Gen. Corp. Law § 61 (Supp. 1960).

27. *Richman v. Felmus*, 8 App. Div. 2d 985, 190 N.Y.S.2d 920 (2d Dep't 1959) (mem.).

28. *York Properties, Inc. v. Neidoff*, 10 Misc. 2d 439, 170 N.Y.S.2d 683 (Sup. Ct. 1957).

29. *Weinstein v. Behn*, 65 N.Y.S.2d 536 (Sup. Ct. 1946), aff'd mem., 272 App. Div. 1045, 75 N.Y.S.2d 284 (1st Dep't 1947).

against any defendant and is not limited to an action brought under section 60.³⁰

There is no corresponding obstacle to the institution of a director's suit, since the contemporary ownership rule applies only to a shareholders' action.³¹ Thus, a director may sue for acts of misconduct which occurred prior to his election and shareholders may avoid the effect of the rule if they can obtain representation on the board of directors.

IV

PROPER PARTIES

Parties Plaintiff.—A director of a corporation is expressly authorized by statute to bring an action against one or more of the directors or officers of the corporation for acts of misconduct.³² This right exists only if the director is in office at the time the action is commenced.³³ A director's express acceptance of his office is unnecessary to the action. Absent a statute or controlling usage to the contrary, one who is elected a director is presumed to accept the office and, therefore, may maintain the action.³⁴ He remains qualified to do so, absent express acceptance, until he is removed pursuant to the corporate by-laws or until such time elapses that he is presumed to have declined the office.³⁵

A director of a foreign corporation which transacts business and has its principal office in New York, as well as a director of a domestic corporation, can maintain an action.³⁶ The New York Court of Appeals has stated that to restrict the application of the statute to directors of domestic corporations would not be in accord with the broad language of the statute.³⁷ Moreover, such a distinction would be arbitrary since many foreign corporations conduct almost all their business within this state.³⁸

30. *Schwartz v. Kahn*, 183 Misc. 252, 50 N.Y.S.2d 931 (Sup. Ct. 1944).

31. See N.Y. Gen. Corp. Law § 61 (Supp 1960).

32. See N.Y. Gen. Corp. Law § 60 (1943), § 61 (Supp. 1960).

33. *Manix v. Fantl*, 209 App. Div. 756, 205 N.Y. Supp. 174 (1st Dep't 1924); *Rothbart v. Star Wet Wash Laundry Co.*, 185 App. Div. 807, 17 N.Y. Supp. 76 (1st Dep't 1919).

34. *Halpin v. Mutual Brewing Co.*, 20 App. Div. 583, 47 N.Y. Supp. 412 (1st Dep't 1897).

35. *Ibid.* Omission by a director elected in January to attend meetings between January and April did not, as a matter of law, constitute such a long-continued neglect of duty as to amount to an abandonment of office. *Id.* at 585, 47 N.Y. Supp. at 413-14.

36. *Miller v. Quincy*, 179 N.Y. 294, 72 N.E. 116 (1904). Accord, *Acken v. Coughlin*, 103 App. Div. 1, 92 N.Y. Supp. 700 (1st Dep't 1905). See *Kehaya v. Axton*, 32 F. Supp. 266 (S.D.N.Y. 1940), in which the court assumed for the purposes of argument that § 61 applied to foreign corporations without a place of business in New York, provided that personal jurisdiction over the directors was obtained according to New York practice. However, in *Kehaya v. Axton*, 30 F. Supp. 838 (S.D.N.Y. 1940), jurisdiction was obtained by attaching defendants' property located in New York. Thereafter, defendants made a general appearance.

37. *Miller v. Quincy*, *supra* note 36, at 299-300, 72 N.E. at 118.

38. *Id.* at 299-300, 72 N.E. at 117. Two consequences of a holding that the statute refers only to directors of a domestic corporation apparently influenced the court. First, such a holding would logically compel a further holding that only creditors of

The director's action under the statute is several and not joint.³⁹ Thus, a single director may prosecute the action without joining any of his co-directors.⁴⁰ Neither is it necessary to join other persons named in section 61.⁴¹ It has been held that a general creditor is not a necessary party in a director's action for an accounting because all the rights of the plaintiff-director, the defendants and the corporation can be determined without joining the general creditor.⁴² Although the benefits of a director's suit inure to the corporation,⁴³ it is not necessary to join the corporation as a party plaintiff.⁴⁴

Parties Defendant.—The actual parties defendant in a director's statutory action are the directors and officers together with other wrongdoers against whom judgment is sought.⁴⁵ The action may be maintained against directors although they have ceased to hold office prior to the commencement of suit.⁴⁶ Thus, an action for an accounting and the cancellation of corporate bonds and mortgages issued for the benefit of three former directors could be maintained. In so holding, the court was influenced by the fact that "the efficiency of the statute would be seriously impaired were it held that the action could only be maintained against directors while in office."⁴⁷

The corporation is the formal or nominal defendant,⁴⁸ but it is not

a domestic corporation are entitled to the benefits of § 61. Secondly, directors of a foreign corporation would be able to mulct the corporation while New York courts would be helpless to redress the wrongs. *Ibid.* The corporation, however, might be adequately protected against this wrong by the shareholders' derivative action. An action by the attorney general is not a satisfactory answer. The attorney general can only bring an action when the public interest is involved. *Swan v. Mutual Reserve Fund Life Ass'n*, 155 N.Y. 9, 49 N.E. 258 (1898); *People v. Lowe*, 117 N.Y. 175, 22 N.E. 1016 (1889).

39. "[T]he same section that authorizes an action to be brought by the Attorney-General on behalf of the People, authorizes it to be brought by one trustee or director of the corporation. We think . . . any one of the directors could bring this action." *Gildersleeve v. Lester*, 68 Hun 532, 534, 22 N.Y. Supp. 1026, 1027 (Sup. Ct. 1893). See *Miller v. Barlow*, 78 App. Div. 331, 79 N.Y. Supp. 964 (1st Dep't 1903).

40. *Gildersleeve v. Lester*, supra note 39 (suit by one trustee).

41. See cases cited in note 39 supra.

42. *Miller v. Barlow*, 78 App. Div. 331, 79 N.Y. Supp. 964 (1st Dep't 1903). The court maintained that the director in bringing the action was a trustee for the creditor. Since the creditor is a beneficiary, his rights are protected by the plaintiff-director who acts in a representative capacity. *Id.* at 335-36, 79 N.Y. Supp. at 967.

43. *Manix v. Fantl*, 209 App. Div. 756, 205 N.Y. Supp. 174 (1st Dep't 1924).

44. *Miller v. Barlow*, 78 App. Div. 331, 79 N.Y. Supp. 964 (1st Dep't 1903). "Nor was it essential that the corporation should have been made a party plaintiff in the action. In a sense the corporation is a party in default and guilty of dereliction of duty, as it is represented by and acts through its directors and officers. The judgment asks for the appointment of a receiver of its property. It was, therefore, properly made a party defendant." *Id.* at 336, 79 N.Y. Supp. at 968.

45. N.Y. Gen. Corp. Law § 60 (1943).

46. *Jacobus v. Diamond Soda Water Mfg. Co.*, 94 App. Div. 366, 88 N.Y. Supp. 302 (1st Dep't 1904).

47. *Id.* at 379, 88 N.Y. Supp. at 311.

48. *Kehaya v. Axton*, 30 F. Supp. 838, 839 (S.D.N.Y. 1940).

always necessary to make it a party. In *Green v. Compton*,⁴⁹ some of the trustees of a corporation instituted an action against other trustees to restrain them from unlawfully transferring corporate property. The defendants claimed that there was a defect in the parties, the corporation not having been joined as a defendant. The court stated that this would be true if the action were brought by a shareholder since his right arises only when the management of a corporation wrongfully refuses to act after demand by the stockholder.⁵⁰ The director, however, has an original right of action under the statute and, therefore, the corporation need not be joined.⁵¹ In reaching this decision, the court distinguished *Miller v. Barlow*,⁵² in which appointment of a receiver and restoration of misappropriated and wasted funds were sought. Joining the corporation as a defendant in order to have it bound by the judgment was the only way in which there could be a determination of all the parties' rights in the controversy.⁵³ In the *Green* case, the litigation could be completed and an injunction granted without joining the corporation.⁵⁴

When an action is brought to set aside an unlawful transfer, the transferee who conspired with the directors can be made a party.⁵⁵ Section 60 authorizes the setting aside of transfers of property, and a transfer cannot be set aside without making the transferee a party. Consequently, it would unreasonably restrict the application of this provision to prohibit the joinder of persons other than directors and officers of the corporation.

V

PLEADING AND PROCEDURE

Complaint.—A director prosecuting an action under section 61 must specifically allege that he was a director at the time of the commencement of the action or he must allege facts which by necessary inference show him

49. 41 Misc. 21, 83 N.Y. Supp. 588 (Sup. Ct. 1903).

50. Id. at 25, 83 N.Y. Supp. at 590.

51. Ibid. Another reason advanced is that the plaintiff acts in a trust relation for the benefit of the corporation. The court states, however, that the corporation is a necessary party in a shareholders' action. 41 Misc. at 25, 83 N.Y. Supp. at 590.

52. 78 App. Div. 331, 79 N.Y. Supp. 964 (1st Dep't 1903).

53. Id. at 336, 79 N.Y. Supp. at 968. Joinder of the corporation is needed to preclude the possibility of a double recovery against the wrongdoers in a subsequent suit by the corporation itself. *Cunningham v. Pell*, 5 Paige Ch. 607 (N.Y. 1836) (shareholders' derivative suit). *Higgins v. Applebaum*, 183 App. Div. 527, 170 N.Y. Supp. 228 (1st Dep't 1918), suggests that the corporation is joined only as a passive recipient of any recovery, since there is no cause of action alleged against it. See also Prunty, *supra* note 6, at 989.

54. The fear of a double recovery does not exist when an injunction alone is demanded. It might be inquired whether the rule should be the same in a shareholders' derivative suit or whether the corporation should always be a necessary party defendant.

55. *Katz v. Braz*, 188 Misc. 581, 66 N.Y.S.2d 722 (Sup. Ct. 1946), *aff'd mem.*, 69 N.Y.S.2d 324 (1st Dep't 1947).

to have been a director.⁵⁶ Failure to do so is a fatal defect.⁵⁷ The director, however, need not state in the title of the action that he is suing in a representative capacity.⁵⁸ This contrasts with a shareholders' derivative suit, in which the shareholder must allege that he is bringing the action on behalf of himself and all other shareholders.⁵⁹ To complete the complaint, the director should set forth the existence of the corporation and the character of the defendants, together with facts which, if proved, would justify the granting of the relief prescribed by section 60.⁶⁰ In both director's⁶¹ and shareholders' suits,⁶² the prayer for relief should ask for an award directly to the corporation.

Pre-Trial Examination.—A director is entitled to a pre-trial examination of the defendants, even though he could obtain information by examination of the corporate books.⁶³ An inspection of the books is no substitute for a formal examination.

Jury Trial.—In a director's statutory action, either party is entitled as a matter of right to demand a jury trial on the issues of negligence.⁶⁴ These issues must be framed pursuant to Section 429 of the Civil Practice Act.⁶⁵ Under that section a party intending to exercise his statutory right to a jury trial must secure a court order directing all issues of fact arising from the alleged negligent act to be plainly and distinctly stated. The order will include only those questions which a jury may properly determine.⁶⁶ The jury does not render a verdict but merely answers the questions submitted in the order. Their answers are conclusive unless the verdict is set aside or a new trial is granted.⁶⁷

Summary Judgment.—Prior to the adoption of Rule 113 of the New York Rules of Civil Practice, a summary judgment could not be granted in an action brought under section 61 to compel a defendant to account for

56. *Rothbart v. Star Wet Wash Laundry Co.*, 185 App. Div. 807, 174 N.Y. Supp. 76 (1st Dep't 1919); *Bellino v. Lerner* (Sup. Ct. 1937), in 97 N.Y.L.J. 1342, col. 2.

57. *Rothbart v. Star Wet Wash Laundry Co.*, supra note 56.

58. *Higgins v. Applebaum*, 183 App. Div. 527, 170 N.Y. Supp. 228 (1st Dep't 1918).

59. *Bako Realty Inc. v. Hays*, 153 N.Y.S.2d 442 (Sup. Ct. 1956), aff'd, 3 App. Div. 2d 834, 163 N.Y.S.2d 938 (1st Dep't 1957); *Glenn, The Stockholder's Suit—Corporate and Individual Grievances*, 33 Yale L.J. 580 (1924).

60. See *Green v. Compton*, 41 Misc. 21, 25, 83 N.Y. Supp. 588, 590 (Sup. Ct. 1903).

61. *Manix v. Fantl*, 209 App. Div. 756, 205 N.Y. Supp. 174 (1st Dep't 1924); N.Y. Gen. Corp. Law § 60 (1943). That no cause of action under §§ 60-61 is stated when an individual recovery is sought, see *Spiegel v. Spiegel* (Sup. Ct. 1950), in 123 N.Y.L.J. 1631, col. 5.

62. *Isaac v. Marcus*, 258 N.Y. 257, 179 N.E. 487 (1932). For the exceptions to this rule, see *Lattin, Corporations* 378-80 (1959); *Stevens, Corporations*, 789-94 (2d ed. 1949).

63. *Burgess v. Stevens*, 148 Misc. 450, 266 N.Y. Supp. 79 (Sup. Ct. 1933).

64. N.Y. Gen. Corp. Law § 61 (Supp. 1960).

65. *Ibid.*

66. That a jury may not determine the amount of damages when impractical to do so, see *Momand v. Landers*, 174 App. Div. 227, 160 N.Y. Supp. 1053 (1st Dep't 1916).

67. N.Y. Civ. Prac. Act § 429. See *Lubuk v. Lubuk*, 181 Misc. 852, 42 N.Y.S.2d 594 (1943) (issue of adultery in divorce proceeding).

mismanagement.⁶⁸ That rule, however, allows summary judgment in any action.⁶⁹ Summary judgment should, therefore, be available in a director's action.

VI

SECURITY FOR EXPENSES AND REIMBURSEMENT

If a plaintiff stockholder suing derivatively cannot show either that he possesses at least 5% of the outstanding shares of any class of stock or voting trust certificates or that his holdings have a market value in excess of \$50,000, the corporation is entitled at any stage in the proceedings before final judgment to require the plaintiff to post security for expenses.⁷⁰ From the language of section 61-b it is clear that the impediment of posting security for expenses does not apply to a director's action under section 61.⁷¹

A former New York statute provided, in part, for the reimbursement by the corporation of the expenses of plaintiff-directors successfully prosecuting an action in its behalf.⁷² Although repealed,⁷³ this provision was merely declaratory of the common law,⁷⁴ so that a successful plaintiff is still entitled to reimbursement.⁷⁵ Since there has never been any provision relating to unsuccessful plaintiff-directors, it could be inferred that an unsuccessful director must bear the burden of the litigation expenses as is the case in a shareholders' derivative suit.⁷⁶ It is submitted that such a result would place a conscientious director in a precarious position when there is reason to believe that other officers or directors are guilty of misconduct. If the director should prove to be unsuccessful, he would be required to pay for the expenses incurred. This possibility might deter him from commencing the action. His failure to bring suit, on the other hand, might constitute a breach of his fiduciary duty to the corporation. He would thus be liable in a derivative suit by the stockholders.⁷⁷ Therefore,

68. *Fiscella v. Fridman*, 169 Misc. 327, 7 N.Y.S.2d 544 (Sup. Ct. 1938).

69. N.Y.R. Civ. Prac. 113.

70. N.Y. Gen. Corp. Law § 61-b (Supp. 1960). Expenses include not only costs and attorneys' fees which may be incurred by the corporation in connection with the action, but also attorneys' fees which may be incurred by other party defendants who may have a right to assess them against the corporation. N.Y. Gen. Corp. Law § 64 (Supp. 1960).

71. de Capriles, *Business Organization*, 35 N.Y.U.L. Rev. 613, 629 n.132, in 1959 Ann. Survey Am. L. 316, 332 n.132 (1960); Prunty, *Business Associations*, 1958 Survey of N.Y. Law, 33 N.Y.U.L. Rev. 1133, 1134 n.6. A director may be required in the court's discretion to post security for costs. N.Y. Civ. Prac. Act § 1523.

72. N.Y. Sess. Laws 1941, ch. 350, § 1. See also *Williams v. Fleming* (Sup. Ct. 1943), in 109 N.Y.L.J. 385, col. 5.

73. N.Y. Sess. Laws 1945, ch. 869, § 2.

74. N.Y. Law Revision Comm'n, Report 161 (1945).

75. That the repeal of this provision was not intended to deprive successful plaintiffs of reasonable expenses and attorneys' fees, see N.Y. Sess. Laws 1945, ch. 869, § 5.

76. *Marony v. Applegate*, 266 App. Div. 412, 42 N.Y.S.2d 768 (1st Dep't 1943); *Drivas v. Lekas*, 265 App. Div. 1003, 39 N.Y.S.2d 15 (2d Dep't 1943) (mem.), modified, 292 N.Y. 204, 54 N.E.2d 365 (1944).

77. See note 16 supra.

to enable a director to properly discharge his responsibilities, litigation expenses should be paid by the corporation, whether or not it receives a benefit, provided there is a reasonable basis for bringing the suit.

VII

DEFENSES⁷⁸

Acquiescence of All Shareholders.—Acquiescence of all the stockholders of a corporation in acts of its directors which are designed to deprive creditors of payment for their claims is not a defense to an action brought by a director or officer under the statute.⁷⁹ It has been said that the director has a duty to protect the rights of creditors.⁸⁰

Unanimous acquiescence by the stockholders would, however, preclude a suit by the corporation⁸¹ or any shareholder.⁸² The theory is that a shareholder or the corporation should not be able to recover benefits which would inure only to shareholders who participated in or ratified the wrong. Furthermore, it seems that unanimous acquiescence would preclude a shareholders' action even though creditors were involved. A shareholder does not have a duty corresponding to a director's duty to protect creditors. The rights of creditors, however, are not impaired by denial of a stockholders' action, since creditors may sue the wrongdoers either for the benefit of the corporation⁸³ or for their own benefit.⁸⁴ Although authority is lacking, it would seem that if no creditors were affected by the wrongful act and the act were ratified by all the shareholders, a director's action under the statute should be barred in order to prevent shareholders from recovering for wrongs in which they participated.

Acquiescence by the Plaintiff-Director in the Wrongful Acts.—A plain-

78. The defense that plaintiff-director obtained his position through fraud, if proved, destroys his position as director ab initio, thus requiring a dismissal of the suit. *Handler v. Belmare Lighting Co.*, 8 Misc. 2d 687, 168 N.Y.S.2d 288 (Sup. Ct. 1957).

Although abatement and lack of standing to sue are defenses, they are discussed separately in the text accompanying notes 94-115 because of their importance.

79. *Halpin v. Mutual Brewing Co.*, 20 App. Div. 583, 47 N.Y. Supp. 412 (2d Dep't 1897).

80. *Williams v. Robinson*, 9 Misc. 2d 774, 775-76, 169 N.Y.S.2d 811, 813 (Sup. Ct. 1957), aff'd mem. sub nom. *Levy v. Whipple*, 5 App. Div. 2d 823, 170 N.Y.S.2d 991 (1st Dep't 1958).

81. *Kent v. Quicksilver Mining Co.*, 78 N.Y. 159 (1879); *Capitol Wine & Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291 (1st Dep't 1950), aff'd mem., 302 N.Y. 734, 98 N.E.2d 704 (1951).

82. *Diamond v. Diamond*, 307 N.Y. 263, 120 N.E.2d 819 (1954).

83. N.Y. Gen. Corp. Law § 60 (1943), § 61 (Supp. 1960). The word "creditor" in § 61 has been construed to mean "judgment creditor." *Belknap v. North America Life Ins. Co.*, 11 Hun 282 (N.Y. 2d Dep't 1877); *Kendall v. Oakland Golf Club*, 123 N.Y.S.2d 907 (Sup. Ct.), aff'd, 282 App. Div. 1057, 126 N.Y.S.2d 379 (2d Dep't 1953), aff'd mem., 307 N.Y. 753, 121 N.E.2d 554 (1954).

84. *Whalen v. Strong*, 230 App. Div. 617, 246 N.Y. Supp. 40 (4th Dep't 1930) (imminently insolvent corporation); *Buckley v. Stansfield*, 155 App. Div. 735, 140 N.Y. Supp. 953 (4th Dep't 1913), aff'd mem., 214 N.Y. 679, 108 N.E. 1090 (1915) (insolvent corporation).

tiff-director will not be estopped from maintaining an action on the ground that he ratified or acquiesced in the wrongs to the corporation.⁸⁵ Since the action is prosecuted on behalf of the corporation and not for the individual plaintiff, his active or passive assent to the wrong will not condone the wrong to the corporation.⁸⁶ It is not clear whether a shareholder is barred from maintaining a derivative suit if he is one of several shareholders who acquiesced in or ratified the act which gave rise to the suit.⁸⁷ Nevertheless, the principle which may be advanced to bar an acquiescing shareholder has no application to an acquiescing director. The shareholder, in instituting suit, acts as a volunteer for the other shareholders, but the director acts in fulfillment of his duty to protect the rights of the corporation.⁸⁸

Statute of Limitations.—The limitations provided in Sections 48(8) and 49(7) of the New York Civil Practice Act would appear applicable to a director's statutory action brought on behalf of the corporation. Section 48(8) provides, in part, a six-year limitation for legal or equitable actions by, or on behalf of, a corporation against a present or former director if the action is (1) for an accounting, (2) to procure a judgment based on fraud or (3) to enforce a common law or statutory liability. A three-year period is applicable, however, if the action is to recover damages or to account for waste or other injury to property.⁸⁹ It has been held that when the complaint alleges that defendant corporate fiduciaries have received money or an equivalent benefit and the allegations of the complaint are sufficient to make them liable for money had and received, the tort may be waived and the six-year period applied.⁹⁰ In the absence of an allegation that the corporate fiduciary benefited personally from the wrong, the theory of implied contract is inapplicable and the three-year tort limitation governs.⁹¹ Normally the statute begins to run from the time the wrong is committed.⁹² In an action

85. *Levinson v. Rosoff* (2d Dep't 1937), in 98 N.Y.L.J. 1927, col. 7; *Williams v. Robinson*, 9 Misc. 2d 774, 169 N.Y.S.2d 811 (Sup. Ct. 1957), aff'd mem. sub nom. *Levy v. Whipple*, 5 App. Div. 2d 823, 170 N.Y.S.2d 991 (1st Dep't 1958).

86. *Williams v. Robinson*, supra note 85.

87. *Williams v. Robinson*, 9 Misc. 2d 774, 776, 169 N.Y.S.2d 811, 814 (Sup. Ct. 1957) (dictum), aff'd mem. sub nom. *Levy v. Whipple*, 5 App. Div. 2d 823, 170 N.Y.S.2d 991 (1st Dep't 1958). That he may maintain the suit, see *Goldberg v. Berry*, 231 App. Div. 165, 247 N.Y. Supp. 69 (1st Dep't 1930).

88. *Williams v. Robinson*, supra note 87, at 775, 169 N.Y.S.2d at 813.

89. N.Y. Civ. Prac. Act § 49(7). *Gross v. Price*, 128 N.Y.S.2d 209 (Sup. Ct. 1953), modified mem., 284 App. Div. 964, 134 N.Y.S.2d 649 (2d Dep't 1954), held that when a shareholders' action has not been barred by the three- or six-year statute of limitations, the defense of laches is not available. The defense of laches could be raised in a director's statutory action before the statute of limitations had run. See *Jacobus v. Diamond Soda Water Mfg. Co.*, 94 App. Div. 366, 88 N.Y. Supp. 302 (1st Dep't 1904). However, there seems to be no reason why the holding of the *Gross* case, supra, should not be equally applicable to a director's action.

90. *Myer v. Myer*, 271 App. Div. 465, 66 N.Y.S.2d 83 (1st Dep't 1946), aff'd mem., 296 N.Y. 979, 73 N.E.2d 562 (1947); *Gottfried v. Gottfried*, 50 N.Y.S.2d 951 (Sup. Ct. 1944), modified, 269 App. Div. 413, 56 N.Y.S.2d 50 (1st Dep't 1945).

91. *Ross Indus. Corp. v. Bentley*, 85 N.Y.S.2d 215 (Sup. Ct. 1944).

92. See *Schmidt v. Merchants Despatch Transp. Co.*, 270 N.Y. 287, 200 N.E. 824 (1936).

based on actual fraud, however, the limitation would seem to run from the time of discovery.⁹³

VIII

ABATEMENT

In *Hamilton v. Gibson*,⁹⁴ plaintiff brought a director's statutory action against his co-directors for mismanagement of corporate affairs. While the action was pending, plaintiff failed of re-election at the annual meeting. Defendants' motion to vacate an order requiring a pre-trial examination on the ground that the action had abated was denied. The appellate division, reversing, held that the action under the statute had abated. The court reasoned as follows:

It is a director, in virtue of his office, that the statute authorizes to sue, not the individual who holds the office. It seems to follow that when the plaintiff ceased to be a director, and thereby lost the only qualification to sue which he ever possessed, the action must have abated, since the plaintiff, to wit, C. E. Hamilton as director, had ceased to exist. . . . When he ceases to be a director . . . his cause of action cannot survive.⁹⁵

However, in *Manix v. Fantl*,⁹⁶ the appellate division reversed its position. The court recognized that the basis of the *Hamilton* decision was that the cause of action under the statute was personal to the director and distinct from that of the corporation for the same acts of misconduct. The court in *Manix* stated that the statute did not create a new cause of action but merely qualified a director and certain other persons to enforce an existing cause of action.⁹⁷ Since the cause of action belongs to the corporation and is brought for its benefit, the action survives the director's loss of office during the pendency of the action.⁹⁸ If the action did not survive loss of office, the defendant directors could in many cases frustrate the purpose of the statute by legally ousting⁹⁹ the plaintiff from office or preventing his re-election.¹⁰⁰

93. *Myer v. Myer*, 271 App. Div. 465, 475-76, 66 N.Y.S.2d 83, 93 (1st Dep't 1946) (dictum), aff'd mem., 269 N.Y. 979, 73 N.E.2d 562 (1947).

94. 145 App. Div. 825, 130 N.Y. Supp. 684 (1st Dep't 1911).

95. *Id.* at 827, 130 N.Y. Supp. at 685-86. N.Y. Code Civ. Proceed. § 755 (Banks & Bros. 1904) (now N.Y. Civ. Prac. Act § 82) provided that "an action does not abate by any event, if the cause of action survives or continues." Finding that the cause of action did not survive, the court held that the action had abated. 145 App. Div. at 828, 130 N.Y. Supp. at 686.

96. 209 App. Div. 756, 205 N.Y. Supp. 174 (1st Dep't 1924).

97. *Id.* at 759, 205 N.Y. Supp. at 176. That the statute did not create a new cause of action, see *People v. Equitable Life Assur. Soc'y of the United States*, 124 App. Div. 714, 109 N.Y. Supp. 453 (1st Dep't 1908).

98. 209 App. Div. at 758, 205 N.Y. Supp. at 176.

99. An illegal ouster would have no effect on plaintiff's right to continue the suit. *Wyckoff v. Sagall*, 16 Misc. 2d 630, 56 N.Y.S.2d 392 (Sup. Ct. 1945); *Wangrow v. Wangrow*, 211 App. Div. 552, 557-58, 207 N.Y. Supp. 132, 137 (1st Dep't 1924) (dictum reaffirming *Manix*).

100. This consequence would not have justified a holding that the action did not abate if the court had held that the cause of action was personal to the director. See note 95 supra. On the other hand, once the court decided that the cause of action be-

On the strength of *Manix*, the court in *Abberger v. Kulp*¹⁰¹ refused to grant an injunction to restrain the removal of the plaintiff while the action was pending. The plaintiff had contended that an injunction was necessary since his removal from office would cause the action to abate. In *Kehaya v. Axton*,¹⁰² however, a federal district court declared that it would not follow the *Manix* case, noting that the court of appeals had not dealt with the question of abatement in this context.

It is submitted, however, that the holdings of the *Manix* and *Kehaya* cases are not in conflict. Although *Kehaya* contains some criticism of *Manix*, *Kehaya* did not pass on the question of abatement. It held only that the plaintiff, upon loss of office, had no standing to continue the action.¹⁰³ *Manix*, on the other hand, held that the action does not abate, but did not pass on the issue of standing since it was not presented in the motion to dismiss.

Uncertainty was finally removed in *Tenney v. Rosenthal*,¹⁰⁴ in which the court of appeals held that the action did not abate because in the statutory action the director sues for the benefit of the corporation and not to enforce a personal right. The court distinguished a director's right under sections 60 and 61 from his absolute right of inspection, which is personal to him and terminates when he loses office.¹⁰⁵

IX

STANDING TO SUE

When a director loses his office in the course of an action, two distinct questions, one of abatement and one of capacity to sue, are presented. Both questions must be resolved in the director's favor in order to enable him to continue the litigation.

Although the holding in *Hamilton v. Gibson*,¹⁰⁶ was that the action

longed to the corporation, it was logically compelled to hold that the cause of action survived the plaintiff's ouster and that the action did not abate. Furthermore, in order to avoid frustration of the statute, a court would be justified in holding that the plaintiff maintained his standing to continue the suit although he no longer was a director. E.g., *Tenney v. Rosenthal*, 6 N.Y.2d 204, 213-14, 160 N.E.2d 463, 468, 189 N.Y.S.2d 158, 165 (1959). The *Manix* case did not pass on the question of plaintiff's standing.

101. 156 Misc. 210, 281 N.Y. Supp. 373 (Sup. Ct. 1935).

102. 32 F. Supp. 266 (S.D.N.Y. 1940).

103. "The question here is the loss of status and naught else." 32 F. Supp. at 269. "To hold that if a director, who has sued, loses his status as director further maintenance of the suit by him is barred, does not mean that the cause of action, if there is one, has disappeared." *Id.* at 268-69. But see *Tenney v. Rosenthal*, 6 N.Y.2d 204, 208-09, 160 N.E.2d 463, 465, 189 N.Y.S.2d 158, 161 (1959), where the court cites *Kehaya* as contrary to *Manix* and other similar holdings.

104. 6 N.Y.2d 204, 160 N.E.2d 463, 189 N.Y.S.2d 158 (1959).

105. *Id.* at 209, 160 N.E.2d at 465, 189 N.Y.S.2d at 161. The absolute right to inspect is lost when a director ceases to hold office and only a qualified right exists. *Cohen v. Cocoline Prods., Inc.*, 309 N.Y. 119, 127 N.E.2d 906 (1955).

106. 145 App. Div. 825, 130 N.Y. Supp. 684 (1st Dep't 1911). The holding of this case that the action abated upon plaintiff's loss of office was, in effect, overruled by *Manix v. Fantl*, 209 App. Div. 756, 205 N.Y. Supp. 174 (1st Dep't 1924). See discussion in text at notes 94-98 supra.

abated upon the plaintiff's loss of office, nonetheless, the court in dictum touched briefly on the problem of standing. It stated that "when he [the plaintiff] ceases to be a director his right to maintain the action as such ceases. Thereafter he has no standing to prosecute it."¹⁰⁷ In *Manix v. Fantl*,¹⁰⁸ there is dictum to the effect that, although the right to bring the action attaches to the office of director, the right to continue the action does not necessarily depend upon the continuance in office of the director. The first case to pass on the question was *Kehaya v. Axton*,¹⁰⁹ which held that an ousted director had no capacity to maintain the suit as he no longer represented the corporation. The ousted director's relationship to the corporation could only be that of a self-appointed master of the suit without present or potential interest in the litigation.¹¹⁰ This situation, said the court, invites irresponsibility. Thus, prior to 1959, there were no state court holdings on the problem of a plaintiff-director's standing to continue suit and the only decision in point was that of the federal district court in *Kehaya*.

In *Tenney v. Rosenthal*,¹¹¹ the court of appeals resolved the issue of standing to sue in favor of the ousted plaintiff-director. Judge Fuld, speaking for the court, analogized the ousted director to a guardian ad litem. He rejected any comparison to a shareholders' derivative suit,¹¹² in which a shareholder-plaintiff is automatically disqualified from continuing the action when he sells all his stock.¹¹³ The fiduciary duty of a director as guardian ad litem of the corporation is distinct from the duty which he had prior to instituting the suit. It remains unaffected "by the fact that he is a stranger to his ward."¹¹⁴ This ensures the enforcement of the corporation's cause of action once the suit has been properly commenced notwithstanding the plaintiff's loss of status. The protection afforded extends not only to

107. 145 App. Div. at 827, 130 N.Y. Supp. at 686.

108. 209 App. Div. 756, 759, 205 N.Y. Supp. 174, 176 (1st Dep't 1924) (dictum).

109. 32 F. Supp. 266 (S.D.N.Y. 1940).

110. This is not true if the director is also a shareholder. Unless the certificate of incorporation or the by-laws provide otherwise, the director must be a shareholder. N.Y. Stock Corp. Law § 55 (1951).

111. 6 N.Y.2d 204, 160 N.E.2d 463, 189 N.Y.S.2d 158 (1959).

112. Three reasons were advanced why the rule of automatic disqualification should not apply to a director's action when the plaintiff ceases to hold office. (1) The director's action is based on his fiduciary duty to the corporation, while the shareholders' derivative suit is based on the shareholders' proprietary interest which is lost when he sells the stock. (2) A shareholder in disposing of his stock impliedly abandons the corporation's cause of action. No such inference may be drawn, however, when a director fails to be re-elected, as the director may have been ousted by those who are opposed to the curbing of the abuses upon which the suit is based. (3) The rule is one among several worked out by the courts to avoid potential abuses in derivative suits. The same end is sought by N.Y. Gen. Corp. Law §§ 61, 61-b (Supp. 1960), i.e., enforcement of the corporate cause of action by the method least subject to abuse. Thus, absent a legislative direction, the court felt it should not extend the rule to a director. 6 N.Y.2d at 210-13, 160 N.E.2d at 466-68, 189 N.Y.S.2d at 163-65.

113. See *Gleicher v. Times-Columbia Distributions, Inc.*, 283 App. Div. 709, 128 N.Y.S.2d 55 (1st Dep't 1954) (per curiam).

114. 6 N.Y.2d at 211-12, 160 N.E.2d at 467, 189 N.Y.S.2d at 164.

cases in which a director is defeated for re-election but also to those in which a director, in violation of his obligation, is induced to resign. The court stated, however, that the corporation could take control of the litigation upon a showing that its board of directors was in no way connected with the alleged wrongs.¹¹⁵

X

EFFECT OF SECTION 61 ON SHAREHOLDERS' DERIVATIVE SUITS

Institution of Derivative Suit After Commencement of Director's Action.—The commencement of a director's action will not bar a shareholder from instituting a derivative suit to compel an accounting for the same acts of managerial abuse even though one of the plaintiffs in the derivative action is the director.¹¹⁶ The two suits are different in origin, the shareholders' action being equitable in nature, the director's statutory.¹¹⁷ Moreover, it has been stated that a shareholder has no control over the director's action, and it may be discontinued without regard to his rights.¹¹⁸ However, double expense on the defendants' part should be avoided by staying the shareholders' suit until final determination of the director's action.

Jury Trial.—A derivative action by a stockholder is equitable in character. Therefore, no general right to a jury trial exists.¹¹⁹ The contention that section 61 by implication entitled either party in a shareholders' action¹²⁰ to apply for a jury trial on issues of negligence was rejected in

115. *Id.* at 210, 160 N.E.2d at 466, 189 N.Y.S.2d at 162. The plaintiff could also be disqualified for conflict of interest.

116. *Lowenstein v. Diamond Soda Water Mfg. Co.*, 94 App. Div. 383, 88 N.Y. Supp. 313 (1st Dep't 1904).

117. See notes 6 and 14 *supra* and accompanying text.

118. This was stated in *Lowenstein v. Diamond Soda Water Mfg. Co.*, 94 App. Div. 383, 88 N.Y. Supp. 313, 315, (1st Dep't 1904) (dictum). It is submitted, however, that the rights of the shareholder would be protected although he has no control over the director's action. The plaintiff-director's position in the suit is equivalent to that of a guardian ad litem. Consequently, he should not be able to discontinue the action without first obtaining judicial approval. *Whitten v. Dabney*, 171 Cal. 621, 154 Pac. 312 (1915). Although the *Whitten* case is a shareholder's derivative suit, the court of appeals cited it when applying the guardian ad litem analogy in *Tenney v. Rosenthal*, 6 N.Y.2d 204, 209, 160 N.E.2d 463, 464-65, 189 N.Y.S.2d 158, 162 (1959).

In New York, a shareholder can discontinue a derivative suit at any time prior to final judgment. *Manufacturers Mut. Fire Ins. Co. v. Hopson*, 176 Misc. 220, 25 N.Y.S.2d 502 (Sup. Ct. 1940), *aff'd mem.*, 262 App. Div. 731, 29 N.Y.S.2d 139 (1st Dep't 1941), *aff'd mem.*, 288 N.Y. 668, 43 N.E.2d 71 (1942). However, the shareholder holds any settlement fund he receives as trustee for the corporation. *Clarke v. Greenberg*, 296 N.Y. 146, 71 N.E.2d 443 (1947). The rule of discontinuance in the case of a shareholder is further alleviated by allowing shareholders who have no knowledge of the pending action to institute a separate one. *Dresdner v. Goldman Sachs Trading Corp.*, 240 App. Div. 242, 269 N.Y. Supp. 360 (2d Dep't 1934). Moreover, a discontinuance will not bar a later action by another shareholder. *Manufacturers Mut. Fire Ins. Co. v. Hopson*, *supra* at 226, 25 N.Y.S.2d at 508 (dictum). Of course, a later suit will be barred if the statute of limitations has run. This is one of the evils of allowing a shareholder to discontinue the suit at any time prior to final judgment.

119. *Brinckerhoff v. Bostwick*, 105 N.Y. 567, 12 N.E. 58 (1887).

120. A shareholder's derivative action is not within N.Y. Gen. Corp. Law § 60

Bookbinder v. Chase Nat'l Bank.¹²¹ The court stated that if the legislature had intended to extend the right of jury trial to actions other than those brought pursuant to sections 60 and 61 it would have expressly done so.¹²²

XI

EFFECT OF SECTION 61 ON PRESIDENT'S IMPLIED POWER TO INSTITUTE SUIT

In *West View Hills, Inc. v. Lizau Realty Corp.*,¹²³ the president, who was also a director and shareholder, instituted suit in the name of the corporation against a majority of the board of directors for a violation of their fiduciary duties. The court of appeals held that, absent a provision in the by-laws or a prohibition from the board, the president has presumptive authority to institute action in the name of the corporation to protect and preserve its interests, even though he is, in effect, suing a majority of the board.¹²⁴ Judge Froessel, in a vigorous dissent, stated that the majority opinion exalted form over substance since there can never be implied or presumptive authority when the president has actual knowledge that a majority of the directors oppose the suit.¹²⁵ He stated that the proper remedy in this situation is a shareholders' derivative suit.¹²⁶

The problem of the president's implied power to institute suit in the name of the corporation can easily be avoided by bringing an action under section 61, which permits officers as well as directors to institute suit against other officers or directors for acts of misconduct.¹²⁷ The continuance of the suit would be safeguarded by the rule of *Tenney v. Rosenthal*,¹²⁸ which would seem equally applicable to an officer who also serves in a fiduciary capacity.¹²⁹ Despite this solution, the problem may be kept alive by the question of reimbursement in an unsuccessful action brought under section 61.¹³⁰ No case has decided who must bear the litigation expenses in such an action. If the officer or director who brings suit under section 61 must

(1943), § 61 (Supp. 1960). *Gans v. Hearst*, 173 Misc. 662, 17 N.Y.S.2d 834 (Sup. Ct. 1939), aff'd mem., 259 App. Div. 861, 20 N.Y.S.2d 400 (1st Dep't 1940).

121. 244 App. Div. 650, 280 N.Y. Supp. 393 (1st Dep't 1935).

122. Id. at 652, 280 N.Y. Supp. at 395.

123. 6 N.Y.2d 344, 160 N.E.2d 622, 189 N.Y.S.2d 863 (1959), 1959 Survey of N.Y. Law, 34 N.Y.U.L. Rev. 1432-33.

124. 6 N.Y.2d at 348, 160 N.E.2d at 625, 189 N.Y.S.2d at 866.

125. Id. at 349-50, 160 N.E.2d at 625, 189 N.Y.S.2d at 867 (dissenting opinion).

See also *Tidy-House Paper Corp. v. Adlman*, 4 App. Div. 2d 619, 168 N.Y.S.2d 448 (1st Dep't 1957).

126. 6 N.Y.2d at 350, 160 N.E.2d at 626, 189 N.Y.S.2d at 868 (dissenting opinion).

See *Schulman v. Adlman*, 191 N.Y.S.2d 890 (Sup. Ct. 1959).

127. N.Y. Gen. Corp. Law § 60 (1943), § 61 (Supp. 1960).

128. 6 N.Y.2d 204, 160 N.E.2d 463, 189 N.Y.S.2d 158 (1959).

129. This is a necessary result in the case of a president, since he must be chosen from among the directors. N.Y. Stock Corp. Law § 60 (1951). But see Study Bill, S. 3316, art. 7, § 23 (Feb. 15, 1960).

130. On the question of reimbursement, see text at note 76 supra. Even if reimbursement were allowed, the amount of the initial outlay to commence and maintain the suit may cause the president to sue in the name of the corporation rather than under section 61.

pay the expenses when the corporation receives no benefit, a president would be inclined to bring suit on the principle of *West View Hills*, in which case the corporation would bear all expenses. Even if the plaintiff in an unsuccessful section 61 action did not have to pay litigation expenses, the problem of the president's implied authority to sue in the corporate name would remain important in actions against outsiders, as section 61 applies only to actions against officers and directors of the corporation.¹³¹

XII

CONCLUSION

From the preceding discussion it can be seen that the director's action has several advantages over a shareholders' derivative suit.

1. Demand on the board of directors is necessary as a condition precedent to the institution of a shareholders' derivative action.¹³² Furthermore, when the wrong is subject to shareholder ratification, a demand on the shareholders is also required.¹³³ The requirement of demand does not apply to a director's statutory action.¹³⁴

2. A shareholder must have owned his stock at the time of the wrong of which he complains.¹³⁵ The director need not have been a director at the time the cause of action arose.¹³⁶

3. The security-for-expense requirement is a serious obstacle to a shareholders' action¹³⁷ but has no application to a suit brought by a director under section 61.¹³⁸

4. An unsuccessful shareholder cannot be reimbursed for his litigation expenses.¹³⁹ The rule may be otherwise in a director's action.¹⁴⁰

5. Acquiescence by the plaintiff-shareholder in the wrong of which he complains may estop him from bringing suit.¹⁴¹ Acquiescence by a plaintiff-director is no defense to an action under section 61.¹⁴²

6. Loss of stock by a shareholder maintaining a derivative action will automatically terminate his standing to continue the suit.¹⁴³ However, loss

131. N.Y. Gen. Corp. Law § 60 (1943) specifies the persons against whom a § 61 action may be brought. The issue would be important in cases similar to *Matter of Arbitration between Paloma Frocks, Inc. and Shamokin Sportswear Corp.*, 3 N.Y.2d 572, 147 N.E.2d 779, 170 N.Y.S.2d 509 (1958), and *Sterling Indus., Inc. v. Ball Bearing Pen Corp.*, 298 N.Y. 483, 84 N.E.2d 790 (1949).

132. See note 21 *supra* and accompanying text.

133. See note 21 *supra*.

134. See note 22 *supra* and accompanying text.

135. See notes 25-27 *supra* and accompanying text.

136. See note 31 *supra* and accompanying text.

137. Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 32 *Calif. L. Rev.* 123 (1944); Hornstein, *The Future of Corporate Control*, 63 *Harv. L. Rev.* 476 (1950). See note 70 *supra* and accompanying text.

138. See note 71 *supra* and accompanying text.

139. See cases cited in note 76 *supra*.

140. See text accompanying notes 76-77 *supra*.

141. See note 87 *supra* and accompanying text.

142. See note 85 *supra* and accompanying text.

143. See note 113 *supra* and accompanying text.

of office by the plaintiff-director while the suit is pending will not affect the director's standing to continue prosecuting the action.¹⁴⁴

7. A shareholder has complete control over the conduct of the litigation in a derivative suit. It may be, however, that a director cannot arbitrarily discontinue his action.¹⁴⁵

8. A director is likely to be better informed as to acts of misconduct. He is thus better qualified to conduct the litigation.

Although a director's statutory action has been authorized since 1828,¹⁴⁶ case law on the subject is remarkably limited. This proceeding can be particularly valuable in enforcing the fiduciary duties of management in corporations in which there is a minority representation on the board of directors.¹⁴⁷ It is submitted that New York would benefit from increased use of the director's action and that other jurisdictions would profit by its adoption.

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144. See notes 111-15 *supra* and accompanying text.

145. See note 118 *supra*.

146. N.Y. Sess. Laws 1828, ch. 20, § 3 [codified in 2 Rev. Stat. pt. 3, ch. 8, tit. 4, §§ 33, 35 (1829)].

147. A director's suit will probably be brought by a minority faction on the board since a majority of the board could cause the corporation to bring suit and thus avoid any uncertainty as to the expenses of the suit. See text at note 76 *supra*. In a public issue corporation, a director who does not control sufficient votes to ensure his reelection may be deterred from instituting suit by the knowledge that the majority may use proxies to defeat him. This problem will be even more acute in a closely held corporation, in which the majority of the board are probably majority stockholders.