APPLICATION OF THE RULE OF YOUNG v. HIGBEE CO. TO STOCKHOLDER DERIVATIVE SUITS

In Young v. Higbee Co., the Supreme Court surprised corporation lawyers by imposing a fiduciary duty upon preferred stockholders who were contesting a plan of reorganization filed in proceedings under Chapter X of the Bankruptcy Act. It was held that the stockholders who dismissed their appeal and sold their stock for an amount greatly in excess of its market value must account to the other stockholders for the amount received above the value of the stock. The desirability of such a rule deserves serious consideration as a possible means of checking the abuse of stockholder derivative suits.

1 324 U.S. 204 (1945).  
In the *Young* case, Potts and Boag, preferred stockholders, objected that the plan of reorganization allowed the junior creditors too large a share of the corporate assets available for distribution. Had their objection been sustained the value of the claims of all the preferred stockholders would have been increased considerably.\(^3\) When the plan was confirmed by the district court,\(^4\) Potts and Boag appealed individually, all the other preferred stockholders having agreed to the plan. While this appeal was pending Potts and Boag “sold their stock and their appeal”\(^5\) to the junior creditors for an amount over five times the market value of their shares. When the appeal was dropped, Young, another preferred stockholder of the same class, sought to intervene for the purpose of prosecuting the appeal from the district court’s approval of the plan. The circuit court denied intervention.\(^6\) Later, Young brought a class suit, requesting that he be authorized to employ counsel to compel Potts and Boag to account to the corporation or to the preferred stockholders for the difference between the amount received and the fair value of their stock.

In deciding that Potts and Boag must account to the other preferred stockholders, the United States Supreme Court reasoned that by undertaking to prosecute an appeal Potts and Boag exercised a control over the interests of the other preferred stockholders. This control imposed a duty upon them to act in good faith toward the other members of the class. This duty was breached by the pocketing of the amount received for the sale of their stock and the appeal. The Court said:

> [Potts and Boag] cannot avail themselves of the statutory privilege of litigating for the interest of a class and then shake off their self-assumed responsibilities to others by a simple announcement that henceforth they will trade in the rights of others for their own aggrandizement.\(^7\)

The Court further observed that the policy of the Bankruptcy Act was to insure a ratable distribution of the corporate assets among classes of stockholders. If Potts and Boag were permitted to retain the full amount received for the sale of their stock, “there would be no ratable distribution of this bankrupt estate.”\(^8\)

\(^3\) Under the plan the junior creditors were to receive $600,000 in new notes of the Higbee Company and 14,549.9 shares of the company’s common stock. Had the objection been sustained, the junior creditors would have received $100,000, the price they had paid at auction sale for the notes of the company. The difference between the $200,000 and what was paid to the holders of the junior debt would have been apportioned among the preferred stockholders.

\(^4\) In re Higbee Co., 50 F. Supp. 114 (Ohio, 1943).


\(^6\) Young v. Higbee Co., 142 F. 2d 1004 (C.C.A. 6th, 1944).

\(^7\) Ibid., at 210. Actually the amount in the bankrupt estate was not decreased by this payment to Potts and Boag. The payment to the objectors came directly from the junior creditors who had borrowed the money from a bank, giving as security the note constituting the junior indebtedness of the Higbee Company.

\(^8\) Ibid., at 210. Actually the amount in the bankrupt estate was not decreased by this payment to Potts and Boag. The payment to the objectors came directly from the junior creditors who had borrowed the money from a bank, giving as security the note constituting the junior indebtedness of the Higbee Company.
In a derivative suit, a stockholder brings an action against a party who he asserts has injured the corporation. The stockholder has this right because the corporation has refused to sue. However, he does not have an individual claim against the alleged wrongdoer; he is only the "instigator of the action" and any judgment against the defendant is in favor of the corporation. There is a striking similarity between the circumstances in the Young case and a derivative suit in which the stockholder-plaintiff agrees with the defendant to dismiss or discontinue the suit in return for the payment to the plaintiff of a substantial sum of money. Such agreements generally take the form of a sale of the plaintiff's stock to the defendant for an amount in excess of the actual worth of the stock. Although such private settlements may take place in a derivative suit brought in good faith, they are more likely to be the result of a "strike suit"—the suit brought by a stockholder on what may be a valid corporate claim for the purpose of exploiting its nuisance value in order to be bought off. The derivative suit has been frequently used for strike purposes. While private settlements usually do not come to the attention of the courts, references in recent decisions to private and profitable settlements of derivative suits indicate the continued use of the derivative suit for strike purposes. That the private settlement of derivative suits is still common is suggested by a recent survey of such actions in New York undertaken by the New York Chamber of Commerce.

9 The stockholder derivative suit is "one of the remedies which equity designed for those situations where the management through fraud, neglect of duty or other causes declines to take the proper and necessary steps to assert the rights which the corporation has." Meyer v. Fleming, 66 Sup. Ct. 382, 386 (1946).

10 McLaughlin, Capacity of a Plaintiff-Stockholder To Terminate a Stockholder's Suit, 46 Yale L.J. 421, 422 (1937); 2 Moore, Federal Practice c. 23.05, p. 2254 (1938); note 38, infra.

11 The corporation is a necessary party in a derivative suit and is joined as nominal defendant. In many cases the real defendants are the directors or officers of the corporation. If the suit is successful the stockholder is allowed the expenses incident to the litigation.

12 The parties may request the court to dismiss the suit or they may agree to discontinue the suit without requesting court action. If the suit is discontinued the court will after a period of time enter an involuntary dismissal of the suit. A suit is "compromised" if the plaintiff agrees to accept for the corporation a settlement of the claim at less than the amount originally demanded.

13 Clarence H. Venner was the most widely known "sue and settle man." Time, July 3, 1933, p. 52. The number of cases which he settled out of court were numerous; the reported suits run into the hundreds. Sears, The New Place of the Stockholder 199 (1929), gives a list of reported cases up to that time; see also 34 Col. L. Rev. 1308, n. 1 (1934). An exposition of the method used by Clarence H. Venner presents a graphic picture of the "private profiteer" in action: "... he would first buy up a few shares of a company's stock, then plough through charters, by-laws, reorganization plans, statutes. If the company, informed of the legal weeds he usually turned up, chose to buy Old Man Venner's stock at his own price, the matter was dropped. If not he would let loose a flock of damaging circulars, scuttle to court to plead the cause of a downtrodden minority stockholder." Time, July 3, 1933, p. 52.

14 See cases cited in notes 29, 30, 32, 34, infra.

15 Franklin S. Wood, Survey and Report Regarding Stockholders' Derivative Suits (1945). Five hundred and seventy-three derivative suits involving publicly held corporations were brought between 1932 and 1942 in the New York Supreme Courts for Kings and New York
In the development of the rules which have limited the freedom of action of the stockholder who undertakes a derivative suit, there appears a conception of stockholder responsibility similar to that expressed by the Court in the Young case. The belief that the stockholder-plaintiff has obligations to the corporation and to the other stockholders is reflected in the attempts of the courts to prevent the bringing of a derivative suit for strike or collusive purposes. Although it is generally said that improper motive is no defense in a derivative suit, courts, in refusing to hear the action or in imposing stricter standards of pleading and proof upon the stockholder-plaintiff, have been influenced by the belief that the suit was brought for the purpose of being bought off. Such a purpose has sometimes been inferred from the fractional stock interest held by the plaintiff, his reputation as a habitual striker, the date of the acquisition of the stock, and the lack of support from other stockholders.

The belief that the stockholder-plaintiff has certain obligations to the corporation and in the Federal District court for the Southern District of New York. In thirteen cases (2 per cent) there were recoveries; sixty (10 per cent) were settled out of court; thirty-three (6 per cent) were settled with court approval; 215 (37 per cent) were dismissed; 155 (27 per cent) were discontinued; and ninety-seven (17 per cent) were pending at the time of the report. The author estimated that in almost 50 per cent of the discontinuances there was a payment to the plaintiff. Ibid., at 6, 33. Writers generally agree that this report prompted the recent amendment to the New York General Corporation Law imposing severe restrictions upon the right to bring a derivative suit. See note 45, infra. Both the report and the legislation have been subjected to severe criticism. See note 50, infra.

16 A derivative suit brought by a stockholder friendly to the defendants for the purpose of preventing or making more difficult the prosecution of a bona fide derivative suit is referred to as a collusive action. Although the collusive action, like the strike suit, may seriously impair the interests of the corporation and the other stockholders, discussion of such an action is beyond the scope of this note.


18 "We notice that plaintiff owns only one-thousandth of one per cent. of the capital stock; that no other shareholder has accepted its invitation to join . . . and that this interest plaintiff bought after the consolidation contract was made . . . . A measure of imperfection in pleading that might well be overlooked in the ordinary controversy should not be disregarded in such a case as this." General Investment Co. v. Lake Shore & M.S. R. Co., 269 Fed. 467, 471 (C.C.N.Y., 1883).

In Windhurst v. Central Leather Co., 191 N.J. Eq. 543, 138 Atl. 772 (1927), a derivative suit was brought by a minority stockholder to restrain merger of corporations. The plaintiff was granted no relief, the court saying, " . . . there is no question in my mind that Windhurst bought into the situation for the purpose of commencing this suit or otherwise to compel the purchase of his stock at a price to be fixed by him . . . . No relief should be afforded the complainants in this court. In view of their conduct, they should be left to their remedy at law." Ibid., at 551 and 775-76. The cases in which courts have been clearly influenced by the belief that the plaintiff brought the suit for the purpose of being bought off are collected in 34 Col. L. Rev. 1308 (1934).
ration and to the other stockholders appears also in the restrictions which have been imposed upon his right to settle or dismiss the suit at will. A derivative suit in which a consent judgment is given is res judicata as to the issues raised in the suit. Furthermore, if the suit is dismissed, certain advantages in the litigation may be lost or the statute of limitations or laches may bar further actions. Thus, if the action were collusive or if it were brought for strike purposes, a compromise or dismissal might be obtained which would injure the interests of the corporation. Because of these possibilities doubts have been raised as to the wisdom of the rule that the plaintiff could compromise or dismiss at will any time before judgment had been entered, providing other stockholders had not intervened. Although in New York the rule remains in effect, its wisdom has been challenged in a recent decision.

In California the plaintiff has been denied the right to dismiss or compromise the corporation's claim without court approval. Federal Rule 23 reflects this belief that the stockholder-plaintiff has certain responsibilities growing out of his position of control over the interests

19 Darraugh v. Carrington, 50 N.Y.S. 2d 481 (Sup. Ct., 1944); Mathews v. American Tobacco Co., 130 N.J. Eq. 470, 23A.2d 301 (1941); Rohrlich, Law and Practice in Corporate Control 166 (1933).


21 13 Fletcher, Corporations § 6019 (Replacement Volume, 1943). The rule is apparently based upon the misconception that the plaintiff asserts an individual right, and the fear that the imposition of too strict a rule would discourage stockholders from bringing such suits. McLaughlin, op. cit. supra, note 10, at 432.

22 "If this were a case of first impression my conclusion might be otherwise. But this court is bound by a line of cases in New York, to the effect that a minority stockholder may discontinue his action at any time before another stockholder has intervened or judgment has been entered." Manufacturers Mutual Fire Ins. Co. of Rhode Island v. Hopson, 176 Misc. 220, 223, 25 N.Y.S. 2d 502, 505 (1940). The court questioned not only the merits of the rule but also the appropriateness of the cases upon which the rule is supposed to rest. However, the court said that it was bound by dicta which "have attained the dignity of binding authority." Ibid., at 226 and 508.

23 Whitten v. Dabney, 171 Cal. 621, 154 Pac. 312 (1915) (court denied the parties' plea for dismissal of a derivative action until it could determine that the corporation's rights were fully protected); cf. Beaudette v. Graham, 267 Mass. 7, 165 N.E. 671 (1929), where the court excluded from evidence a release by the stockholder-plaintiff to the defendant-director, holding that this was not a release from the company so as to affect its rights against the defendant in a suit brought on its behalf by the stockholder.

24 "(a) Representations. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is (1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it, . . . . (c) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of the rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs." Federal Rules of Civil Procedure, Rule 23, 48 Stat. 1064 (1934), 28 U.S.C.A. foll. § 723c (1941).
of the corporation and the other stockholders. Rule 23(c) provides that no class action "shall be dismissed or compromised without the approval of the court," and that before a class action such as a derivative suit may be dismissed or compromised notice must be given to all the other members of the class. Though Rule 23(c) as applied by the courts has been limited in scope, its provisions illustrate the belief that the stockholder-plaintiff has obligations to the corporation and the other stockholders.25

In light of this background it is not surprising that both the federal and state courts have referred to the stockholder-plaintiff in a derivative suit as a fiduciary who must act in the interests of others than himself.26 It is surprising, however, that neither the writers nor the courts have questioned the stockholder's right to retain money which is paid to him in return for the dismissal or discontinuance of the derivative suit.27 Yet not only has no such doctrine been enforced but it appears to have been assumed that it could not be applied.28 In 1889 an action was brought in a New York court to reopen a derivative suit which has been discontinued following a private and highly profitable agreement between the stockholder and the alleged wrongdoer. The court reiterated the New York rule that the stockholder had the right to discontinue the suit, and went on to observe that "it was none of the other stockholders' business how or by what means she did it."29 As recently as 1940 another New York court endorsed this dictum in a case where the stockholder dropped the suit in return for the purchase of his shares for approximately seven times their market value.30 The court remarked that if there were a rule in New York

25 "... the rule was adopted to secure not routine approval of a consent decree, but in order to insure supervision of the court for the protection of the corporation and all the stockholders." Cohen v. Young, 127 F. 2d 721, 725 (C.C.A. 6th, 1942).

26 A fiduciary obligation to the corporation: Goodwin v. Castleton, 19 Wash. 2d 748, 144 P. 2d 725 (1944); Spellacy v. Superior Court in and for Los Angeles, 23 Cal. App. 2d 142, 72 P. 2d 262 (1937). A fiduciary obligation to the other stockholders: Bernheim v. Wallace, 186 Ky. 459, 217 S.W. 916 (1920); see Denicke v. Anglo-California National Bank of San Francisco, 45 F. Supp. 524 (Cal., 1942), in which the stockholder-plaintiff is referred to as a "trustee" for the benefit of the defendant bank and its stockholders. The stockholder-plaintiff has been analogized to a guardian ad litem. Loeb v. Berman, 217 Cal. 716, 20 P. 2d 685 (1933).

27 The attack upon the strike suit has been directed toward making more difficult the insti-tuting and the private settlement of derivative suits. If the obstacles can be overcome, the right to profit by a derivative suit does not appear to be questioned. This assumption is especially surprising in view of the restrictions placed upon the right of an agent to make a secret profit in transactions conducted by him on behalf of his principal. Donçmar v. Molley, 252 N.Y. 360, 169 N.E. 610 (1930); Rest., Agency § 388 (1933).

28 The fact that there is no reported case where a plaintiff has been asked to account to the corporation for the profit he has made from a strike suit suggests that it is commonly believed that such an action would not be successful.


similar to Federal Rule 23(c), "private profiteering" of this kind might be prevented.31

However, Rule 23(c), as it has been applied, has not prevented the "buying off" of the stockholder-plaintiff. In Malcolm v. Cities Service Co.,32 a stockholder abandoned a derivative suit and sold her stock to the defendant for an amount alleged to be considerably in excess of its actual worth. The federal court denied a request that it investigate the facts surrounding the sale, holding that the sale of the plaintiff's stock and the abandonment of the suit did not constitute a "compromise" or a "dismissal" under Rule 23(c). The court said the term "compromise" referred only to a settlement with the corporation and not to a private settlement between the plaintiff and the defendant. The sale of stock did not constitute a "dismissal" because neither party had petitioned the court for dismissal. Thus, neither court approval nor notice to the other stockholders was necessary.33 In Webster Eisenlohr v. Kalodner34 the circuit court was petitioned to set aside an order given by the district judge in a suit brought against the petitioning corporation.35 The district judge, after being advised that the plaintiff has sold his stock to the defendant corporation while the suit was pending, had ordered a special master to investigate the circumstances surrounding the sale. The circuit court held that no such order could be made; "all [the preferred stockholders] had the full legal power to sell their shares under such circumstances as it pleased them to sell."36 The provision of Rule

31 Ibid., at 222 and 509. In New York a court may require notice to all shareholders before a final settlement is entered by the court, if a compromise or settlement is submitted for judicial approval. N.Y. Civ. Prac. Ann. (Cahill, 1937) § 8. However, court approval is not required in New York.


33 But see United States Lines, Inc. v. United States Lines Co., 96 F. 2d 148 (C.C.A. 2d, 1938). Complainant corporation brought a stockholder derivative suit against the alleged wrongdoer, the International Mercantile Marine Company. Later when the defendant acquired the majority of the stock of the complainant, the suit was discontinued in return for a consideration to the preferred stockholders of the complainant. On petition of a preferred stockholder to continue the suit, the circuit court reversed the order of discontinuance. "The settlement . . . did not involve any consideration moving to the company wronged . . . . The settlement accomplished little more than to block a proceeding by a persistent stockholder who sought to have claims of United States Lines Company against the defendants asserted when both it and United States Lines, Inc., were under their [defendants'] control." Ibid., at 152.

34 145 F. 2d 316 (C.C.A. 3d, 1944), one judge dissenting.

35 The suit was a representative action brought by a preferred stockholder on behalf of all other preferred stockholders to compel the corporation to give exclusive voting power to the preferred stockholders.

36 145 F. 2d 316, 319 (C.C.A. 3d, 1944). The evidence showed that the company had offered $750 per 100-share certificate to the plaintiff's attorney for the preferred stock "which his client or those with whom he got in contact, sold to the company." The dissenting judge observed that this was "an astounding commission; more than 2000 per cent above that permitted to a broker on a regulated exchange." Ibid., at 324.
23(c) requiring court approval was held inapplicable since no motion for compromise or dismissal had been made.\textsuperscript{37}

The belief that a stockholder suit may be settled privately has been carried to the extreme of ordering a dismissal of a derivative suit upon payment by the defendant to the plaintiff of the amount by which the latter's stock has been depreciated by the allegedly wrongful dealings.\textsuperscript{38} Since the compromise had not been made with the corporation, the court held that Rule 23(c) was not applicable. Although Rule 23(c) has been referred to by the courts and writers as the best method for curbing the abuse of derivative actions,\textsuperscript{39} its value as a check

\textsuperscript{37} The dissenting judge in Webster Eisenlohr v. Kalodner interpreted Rule 23(c) to mean that the requirements of notice and court approval should be in effect when the suit is compromised or dismissed, whether or not the compromise or dismissal has been submitted to the court for approval. This interpretation would seem to carry out better the purpose of Rule 23(c), which the majority said was to provide against the adverse effect which might result to other interested parties, "when a plaintiff who starts an action becomes faint-hearted before its completion or gets what he wants by compromise." Ibid., at 320. See National Hairdressers' & Cosmetologists' Ass'n v. Philad Co., 4 F.R.D. 166 (D.C. Del., 1944).

\textsuperscript{38} May v. Midwest Refining Co., 121 F. 2d 431 (C.C.A. Ist, 1941). The court said that the derivative suit includes an individual action by the plaintiff against the alleged wrongdoer. To support this concept of a derivative suit the court quoted the following statement from Hornstein, Legal Controls for Intracorporate Abuse—Present and Future, 41 Col. L. Rev. 405, 416 (1941): "... every suit in a derivative capacity necessarily includes a suit in an individual capacity as well." 121 F. 2d 431, 439 (C.C.A. Ist, 1941). The court continued: "Thus the plaintiff is acting in a dual role. He is suing on behalf of this corporation to redress a wrong allegedly done to it, and he is also suing in his own right as a stockholder to redress a wrong which he alleges that he, himself, has sustained by reason of his stock ownership." Ibid. Although the stockholder has sustained a wrong, it is submitted that the court is wrong in holding that he has an individual cause of action against the defendant. Hornstein defines the suit in the "individual capacity" as "... the right of the stockholder to maintain the suit and to compel his recalcitrant corporation to accept the relief which the decree affords." Furthermore, the case which Hornstein cites in the footnote to this remark spells out what this right of the individual is: "A bill filed by stockholders in their derivative right therefore has two phases—one is the equivalent of a suit to compel the corporation to sue, and the other is the suit by the corporation, asserted by the stockholders in its behalf, against those liable to it. The former belongs to the complaining stockholders; the latter to the corporation. The complaining stockholders are allowed in derivative bills to bring forward these two causes of action in one suit." Cantor v. Sachs, 18 Del. Ch. 359, 365-66, 162 Atl. 73, 76 (1932). Thus, the right which the plaintiff in a derivative suit has is the right to maintain the suit, not to collect individually from the defendant. The court referred also to Joyce v. Congdon, 114 Wash. 239, 195 Pac. 29 (1921), to substantiate the fact that relief in derivative suits does not universally run to the corporation. This case and those which follow the doctrine enunciated there are cases in which the beneficiary-corporation is a closed corporation. Since all the stockholders were parties to the suit, and a judgment in favor of the corporation would have meant division among the defendants as well as the plaintiffs, the court avoided such an inequitable result by private payment to the plaintiffs. The May case involves a public corporation.

\textsuperscript{39} "A question of public policy had developed in actions of this type, due to the private and secret settlement of stockholders' suits, made without court review and without notice to other stockholders. Against that unsavory practice the corrective provisions of Rule 23(c) were directed." Winkleman v. General Motors Corp., 48 F. Supp. 504, 514 (N.Y., 1942); McLaughlin, op. cit. supra, note 10, at 433. "Furthermore, notice will tend to lessen strike suits by shareholders, since a shareholder and his counsel will not be able to sue and settle in the dark; and it will prevent unrighteous compromise of a just shareholders' action." Moore, op. cit. supra, note 10, at 2277.
upon strike suits is questionable so long as neither court approval nor notice to the other stockholders is required when the plaintiff has sold his stock to the alleged wrongdoer.  

Other attempts to curb the abuse of the derivative suit do not afford any more satisfactory control over the opportunities for private profit in such an action. The value of motive as a criterion is doubtful. Proposed that the decision to bring a derivative suit should depend upon the approval of a majority of the stockholders would obviously weaken the effectiveness of the suit as a check on management. The requirement that the plaintiff must have held stock at the time of the alleged wrongdoing does not afford much protection against the striker and reflects a questionable assumption that the purchase of stock is made with full knowledge of all the circumstances surrounding the management of the corporation.

Section 61-b of the New York General Corporation Law, passed in 1944 and recently declared unconstitutional by a lower New York court, is the most recent and by far the most drastic of all laws designed to curb the abuse of the derivative action. In 1941 the state legislature enacted section 61-a requiring the corporation to pay the defendants' reasonable expenses, including attorney's fees in the event that the defendants were successful in whole or in part in a derivative suit. Under section 61-b the stockholder-plaintiff who either owns less than 5 per cent of the outstanding shares of any class of stock or has stockholdings with a market value of less than $50,000 may be required to post security to insure payment of court costs and defendants' expenses. While the wisdom of section 61-a is questionable the consequences of section 61-b appear

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40 Even if notice were required it is doubtful whether private settlements would be substantially discouraged. Defendants may consider it less costly to take the chance of additional suits being brought, as a result of notice having been given, than to make a settlement in favor of the corporation subject to judicial review.

41 If the corporation has a good cause of action, the motive of the plaintiff bringing it should make no difference, unless it be collusive. Moreover, it is obviously a difficult test to apply.


43 If the directors are the defendants and a majority of the stock is either friendly to, or controlled by them, the value of such a vote is questionable. McLaughlin, op. cit. supra, note 10, at 433; 44 Yale L. J. 534, 537 (1935).


47 N.Y. Cons. Laws (Thompson, 1944) c. 668, § 61-a. This section was repealed in 1945. The parts of it which are reconcilable with § 61-b are embodied in sections 63-68.
very serious. The statute, based upon the state Chamber of Commerce Report\(^4\) which was, in turn, premised upon the conviction that nearly all derivative suits are unfounded, places on the plaintiff a prohibitive risk which has no parallel in other types of litigation.\(^4\) The severe criticism that has been directed against section 61-b\(^5\) and the belief that it is unconstitutional forecast an early revision or outright repeal of the statute.

It appears that the doctrine of the *Young* case affords the most effective means of checking the opportunity for personal gain in a derivative suit.\(^5\) In place of a complex of rules designed to make more difficult the instigating or settling of a derivative action there would be substituted the prophylactic rule that any private profit made by the plaintiff must be returned to the corporation.

The legal basis for the application of the rule in the *Young* case to derivative suits appears sound. Since the obligation to account to other stockholders of the same class has been imposed upon the objector to a reorganization plan who sells his stock interest for more than its value, it would appear a fortiori a similar duty to the corporation should rest upon the plaintiff in a derivative suit. In the *Young* case it was both necessary and difficult to demonstrate that in spite of the fact that the objectors appealed individually the appeal was in effect a class action.\(^5\) The derivative suit, on the other hand, not only is a class

\(^4\) Wood, op. cit. supra, note 15.

\(^5\) Zlinkoff, The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law, 54 Yale L. J. 352, 372 (1945). Writers are generally favorable in principle to the stockholder derivative action. "[The action is] the main instrument available to an oppressed minority for curbing otherwise unlimited managerial power and for recouping corporate losses." McLaughlin, op. cit. supra, note 10, at 427. "Strike suits are not an unmixed evil. The threat of them may tend to keep corporate managers within their legitimate powers," 34 Col. L. Rev. 1308, 1321 (1934). "... it is to the interest of society that the stockholder not only be permitted to bring suit on behalf of his corporation, but that he be encouraged to take the initiative." Hornstein, Counsel Fee in Stockholder's Derivative Suits, 39 Col. L. Rev. 784, 791 (1939); see Kalven and Rosenfield, Contemporary Function of the Class Suit, 8 Univ. Chi. L. Rev. 684, 693 (1941).


\(^5\) Indeed, some rules designed to discourage private settlements have encouraged the bringing of additional suits on the same cause of action with no assurance that the risk of private settlements has been eliminated. In Dresdner v. Goldman Sachs Trading Corp., 240 App. Div. 242, 247, 269 N.Y. Supp. 360, 366 (1934), the court permitted the filing of duplicate derivative actions because there was "nothing to prevent the defendants from buying their peace with the plaintiffs by means of a private settlement." In a subsequent case twelve separate actions for the benefit of the same corporation were pending in the same court at the same time. Brendle v. Smith, 46 F. Supp. 522, 523, (N.Y., 1942).

\(^5\) "... even though their objection to confirmation contained no formal class suit allegations, the success or failure of the appeal was bound to have a substantial effect on the interests of all other preferred stockholders. The liability of one who assumes a determining position over the rights of others must turn on something more substantial than mere formal allegations in a complaint." Young v. Higbee Co. 324 U.S. 204, 209 (1945); see 45 Col. L. Rev. 625 (1945).
action but, unlike some class actions, the stockholder-plaintiff does not have an individual claim at stake. As the plaintiff, he litigates for the interest of the corporation and, in effect, the other stockholders. Furthermore, the Court's argument in the *Young* case as to the necessity for an equitable distribution of corporate assets may be applied with greater force to the derivative suit. The cause of action which the stockholder-plaintiff seeks to enforce is a corporate asset. When the plaintiff is permitted to make a private profit out of the discontinuance of a derivative suit he may obtain the only benefit from this asset.

It is not suggested that the application of the rule in the *Young* case to derivative suits would eliminate all the possible ways by which that action may be traded upon for personal gain. The rule would not effectively discourage the derivative suit in which the plaintiff's attorney is the real instigator of the action and the stockholder only a convenient straw man. In such cases it is not the hope of being bought off but the assurance of sizable counsel's fees in the event of compromise or victory which lies behind the lawsuit. Indeed, it is possible that the imposition of a duty such as was invoked in the *Young* case would result in negotiations wherein the price paid for discontinuance took the form of attorney's fees rather than direct payment to the stockholder-plaintiff. Furthermore, where the striker is bought off before the filing of any complaint, the difficulties of investigating the facts surrounding the private settlement would conceivably be far greater than was the case in *Young v. Bigbee* where the sale was made pending an appeal.

In contrast to the plaintiff in a derivative suit, the creditor or stockholder who sues the corporation on behalf of himself and all others similarly situated to compel the corporation to declare a dividend or to enjoin a proposed merger, consolidation, or liquidation, sues upon an individual claim as well as the representative of a class. For a discussion of the three types of class actions, see Moore, op. cit. supra, note 10, at § 23.04.

How disproportionate is the striker's share may be emphasized by noting the amount which an individual shareholder would get if the recovery were divided equally among the shareholders. For example, in Winkleman v. General Motors Corp., 48 F. Supp. 504 (N.Y., 1942) the $4,500,000 compromise approved by the court was the largest settlement obtained in any derivative action brought in New York. Wood, op. cit. supra, note 15, at 50. This sum was approximately eight cents a share. A recovery is valuable, however, as a deterrent to future misconduct by management; and in many cases the amount recovered may substantially strengthen the financial position of the corporation.

The requirement of court approval of attorney's fees (Fletcher, op. cit. supra, note 21, at § 6049, p. 459) provides the best method of insuring the reasonableness of such expenses incident to the suit.

"Making it easier for the legitimate plaintiff and harder for the illegitimate is a problem which will never be solved, but some progress can be made." Douglas, Directors Who Do Not Direct, 47 Harv. L. Rev. 1305, 1327 (1934).