ment[21]—the clause has no effect on the rights of the parties, and the instrument is to be construed as if the facility of payment clause were not included.[22] Thus if the beneficiary has not claimed payment within the 30 days, and if the company has not exercised its option after the period has expired, only the beneficiary should have a right to institute proceedings to recover the proceeds of the policy. He should occupy the same status under these circumstances as the beneficiary under any ordinary policy of insurance. It follows that once proceedings were instituted, the beneficiary's right to payment should have been recognized as vested.

Consideration of the intention of the insured, the rights of the beneficiary under ordinary life insurance, and the purposes of small industrial policies, point to the need for recognition by the courts of a vested claim in the named beneficiary, subject to being divested upon payment by the insurer to one who has already supplied funds to accomplish the task for which the proceeds of the policy were intended. Recognition by the courts of a right of action in the beneficiary may well be an inducement to prompt payment and tend to restore the advantages to the insured's estate and loved ones which can arise from the inclusion of facility of payment clauses in industrial insurance policies.[23]

APPLICATION OF STRIKE SUIT STATUTES IN FEDERAL COURTS

The plaintiff, owning a fraction of one per cent of the stock in a Delaware corporation, filed, on diversity grounds, a derivative suit in a New Jersey federal district court against the corporation's officers and directors.[1] Before the determination of the suit, the New Jersey legislature passed a law requiring as a condition precedent to a derivative action that a plaintiff hold shares either worth $50,000 or constituting five per cent of the value of all outstanding shares.[2] Otherwise, the corporation might require that the complainant give security for "reasonable expenses," including counsel fees incurred by the cor-

[21] Prudential Ins. Co. v. McMahon, 60 R.I. 446, 199 Atl. 305 (1938); Pashuck v. Metropolitan Life Ins. Co., 124 Pa. Super. Ct. 406, 188 Atl. 614 (1936); Prudential Ins. Co. v. Tutalo, 55 R.I. 160, 178 Atl. 859 (1935); Prudential Ins. Co. v. Godfrey, 75 N.J. Eq. 484, 72 Atl. 456 (1909); Floyd v. Prudential Ins. Co., 72 Mo. App. 455 (1897). But see Slingerland v. Prudential Ins. Co., 94 N.J.L. 532, 110 Atl. 913 (1920) (mere assertion of a claim by beneficiary or administrator does not terminate company's right to make payment under the facility of payment clause).

[22] Uptegrove v. Metropolitan Life Ins. Co., 145 Neb. 51, 15 N.W. 2d 220 (1944); Pashuck v. Metropolitan Life Ins. Co., 124 Pa. Super. Ct. 406, 188 Atl. 614 (1936); In re O'Neill's Estate, 143 N.Y. Misc. 69, 255 N.Y. Supp. 767 (1932); Williams v. Metropolitan Life Ins. Co., 233 S.W. 248 (Mo. App., 1921).

[23] For a discussion of how the facility of payment clause is actually administered by the companies see Fuller, The Special Nature of the Wage Earner's Life Insurance Problem, 2 Law & Contemp. Prob. 10, 30 (1935).

[1] See Cohen v. Beneficial Industrial Loan Corporation, 7 F.R.D. 352 (1947).

[2] N.J. Rev. Stat. (Supp., 1947) tit. 14, c. 3, §§ 15, 17.

poration or by the defendant officers.[3] The corporation's motion for an order requiring the complainants to give $125,000 security was denied on the ground that the statute was "procedural" and, accordingly, not binding on the federal courts. On appeal by the corporate defendant, the plaintiff challenged both the constitutionality of the statute, particularly in its retroactive application, and its applicability in the federal courts. The Court of Appeals for the Third Circuit rejected these conditions and reversed the decision below. *Beneficial Industrial Loan Corporation v. Smith.*[4]

This decision departs from the approach of the district courts in the second circuit. There the application of the parent security bond statute, Section 61(b) of the New York General Corporations Act,[5] in federal courts with diversity jurisdiction was denied on the ground that the statute was purely procedural.[6] While perhaps in accordance with conflict of laws criteria,[7] these decisions have

[3] The corporation's by-laws included a provision under which the corporate officers were to be indemnified by the corporation for reasonable expenses, including counsel fees, incurred in successfully defending against claims and demands brought against them as officers of the corporation. This by-law, Article X, is set forth in the margin at page 48 of Beneficial Industrial Loan Corp. v. Smith, 170 F. 2d 44 (C.C.A. 3d, 1948).

[4] 170 F. 2d 44 (C.C.A. 3d, 1948).

[5] N.Y. General Corporations Law (McKinney, 1948) c. 22, § 61(b).

[6] Section 61(b)'s application in federal courts was tested in three cases: Boyd v. Bell, 64 F. Supp. 22 (N.Y., 1945); Craftsman Finance and Mortgage Co. v. Brown, 64 F. Supp. 168 (N.Y., 1945); and Donovan v. Queensboro Corporation, 75 F. Supp. 131 (N.Y., 1947). The Boyd case held that Section 61(b), being clearly remedial, was not applicable. The Donovan case held the statute applicable at the discretion of the judge. Judge Leibell in the Craftsman Finance case acknowledged the necessity of enforcing state policy but asserted that Federal Rule 23(c), 28 U.S.C.A. foll. § 723(c) (1948), requiring court approval of private settlements served much the same purpose as Section 61(b). This might be the case if one were to judge from such statements as that in part of Governor Dewey in signing the bill. N.Y. Times, p. 22, col. 4 (Apr. 12, 1944). However, it is apparent that the framers of this statute were as much concerned with groundless as with valid actions designed to enrich plaintiff's attorneys rather than the corporation. See Wood, Survey and Report regarding Stockholders' Derivative Suits (1944). The Wood Report, undertaken for the New York State Chamber of Commerce, the sponsor of the bill, formed the basis for the security bond legislation.

In Aspinook v. Bright, 165 F. 2d 294 (C.C.A. 2d, 1947) the second circuit court of appeals has expressed approval of the district courts' holdings. After declining to entertain an immediate appeal, the court was asked by the corporation to issue a mandamus to the district court requiring it to exact security requirements (as under Section 61[b]) on the ground that the plaintiff stockholder may fail to appeal an adverse verdict, saddling the corporation with its officers' expenses under Section 64 of the General Corporations Act. The court refused to hear the petition for mandamus. In a dictum the majority called attention to the possible unconstitutionality of the statute. Frank, J., concurring, would have considered the mandamus petition on its merits holding the statute inapplicable in federal courts.

The U.S. Supreme Court has granted certiori to Cohen v. Beneficial Industrial Loan Corporation, 69 S. Ct. 642 (1949). Presumably, the conflict between the circuits was one of the reasons.

[7] The conflict of laws rule is, of course, that the procedural rules of the forum prevail. However, it is increasingly evident that there exist numerous rules procedural in that they do not define causes of action, that express fundamental policies of jurisdictions. The result is that courts classify these rules (such as those concerning burden of proof of absence of contributory negligence, res ipsa loquitur, etc.) more and more as lex loci. A comprehensive dis-

been criticized as antagonistic to the approach reflected in *Erie Railroad v. Tompkins*[8] and culminating in *Angel v. Bullington*[9] where the Supreme Court has defined the discretionary powers of federal courts with diversity jurisdiction in increasingly narrow terms, terms totally independent of the procedural-substantive dichotomy.[10]

Under the doctrine of these cases, federal courts exercising diversity jurisdiction are to apply state rules reflecting important state policies. "The essence of diversity jurisdiction is that a federal court enforces State law and State policy."[11] The classification of a law as "merely procedural" will not result in its being ignored by federal courts so that "the accident of citizenship becomes decisive of the litigation."[12] A federal court with diversity jurisdiction does not, under the rules of the *Erie* and *Angel* cases, act as independently as would a state court applying foreign law.

The court in the instant case recognized this when it stated the crucial question as ". . . can [the plaintiff] escape the limitation of the New Jersey statute by entering the federal court house rather than that of the State?"[13] Its negative

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cussion of this problem is found in Sampson v. Channel, 110 F. 2d 754 (C.C.A. 1st, 1940), a case demonstrating that the rigorous substantive-procedural categories are breaking down. In the Sampson case the problem arose of application of state conflict of laws rules by federal courts with diversity jurisdiction. There was an automobile collision in Maine, where the burden of proving the absence of contributory negligence rests on the plaintiff. The case was tried before a federal district court in Massachusetts where that burden is on the defendant and where the evidentiary rule is regarded as procedural. The result was that the Massachusetts court used the local rule even where the cause arose in a foreign state with the opposite rule. On appeal, Magruder, J., held that the Massachusetts conflict of laws rule was substantive for this case and therefore binding on federal courts. An excellent theoretical discussion of this question is found in Cook, The Logical and Legal Bases of the Conflict of Laws c. vi (1942). See also Morgan, Choice of Law Governing Proof, 58 Harv. L. Rev. 153 (1944).

[8] 304 U.S. 64 (1938).

[9] 330 U.S. 183 (1947). See also Guaranty Trust Co. v. York, 326 U.S. 99 (1945), requiring federal application of state statutes of limitation in a case where the federal rule would not have barred the action.

[10] See Tunks, Categorization and Federalism: "Substance" and "Procedure" after Erie Railroad v. Tompkins, 34 Ill. L. Rev. 271 (1939). Professor Moore has criticized the second circuit cases as being directly contrary to Angel v. Bullington. 3 Moore, Federal Practice 3504 et seq. (2d ed., 1948). He also discusses a parallel problem (ibid., at 3489 et seq.), the application of Rule 23(b) of the Federal Code of Civil Procedure, requiring that Plaintiffs be shareholders at the time of the transactions complained of, to cases where federal jurisdiction is based on diversity. Here too, the cases have been decided mechanically, with emphasis on the procedural context of the rule rather than the operative effect on the substantive rights of the parties. Yet Dean Pound has said the rule has its basis "in a sound and wholesome principle of equity." Fire Insurance Co. v. Barber, 67 Neb. 664, 658, 93 N.W. 1024, 1029 (1903). Professor Moore appears to favor a limited application of Rule 23(b) in subordination to the enforcement of state policy in questions decided under diversity jurisdiction.

[11] Angel v. Bullington, 330 U.S. 183, 191 (1947). The Supreme Court held here that if a state gives no remedy without abolishing the cause of action itself, federal courts cannot give relief. This holding is of critical importance, demanding as it does that federal courts with mere diversity jurisdiction make a serious attempt to enforce state policy.

[12] Sampson v. Channel, 110 F. 2d 754, 758 (C.C.A. 1st, 1940).

[13] Beneficial Industrial Loan Corp. v. Smith, 170 Fed. 2d 44, 54 (C.C.A. 3d, 1948).

answer appears to be well within a proper interpretation of the *Erie* doctrine, it being universally accepted—both by the statute's supporters and critics—that it profoundly influences the stockholders' derivative action.[14] The security bond statutes were viewed by their framers as an important extension of previous remedies against unjustifiable litigation and abuse of process.[15] The ordinary remedy of indemnification through assessment of court costs against unsuccessful plaintiffs was notoriously inadequate, usually representing a nominal sum.[16] An action in tort for unjustifiable litigation is almost invariably inappropriate or useless.[17]

The court found that the statute was but an extension of the New Jersey statute "by which the court of chancery in New Jersey is empowered to award counsel fees and costs between party and party."[18] The New Jersey Supreme Court has upheld the constitutionality of the latter provision as applied to pending actions. It followed that the retroactive provision in question was also constitutional. But the position of the corporation is so greatly improved by the statute that it might be considered to have achieved a new "substantive right." This is—at least by implication—the view of the New York State Court of Appeals.[19] Similarly, the potential liability imposed by the law on the plaintiff could be said to effect a substantive change in his legal rights.[20] These considerations might well move an unsympathetic court to hold the retroactive application of the security bond statutes unconstitutional.[21] The Court of Appeals for

[14] The opponents of this statute would appear to regard it as a disastrous obstacle to the effective enforcement of the fiduciary obligations of corporate officers. Zlinkoff, The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Laws, 54 Yale L.J. 352 (1945); Hornstein, New Aspects of Stockholders' Derivative Suits in New York, 47 Col. L. Rev. 1 (1947); Hornstein, Death Knell of Stockholders' Derivative Suits in New York, 32 Calif. L. Rev. 123 (1944).

Its supporters regard it as the answer to abuses of the grossest nature, particularly in connection with unethical legal practices. See Governor Dewey's statement, op. cit. supra note 6; Wood Report, op. cit. supra note 6.

[15] See citations in second paragraph of note 14 supra.

[16] Prosser, Torts 886 (1941); McCormick, Damages c. 8 (1935).

[17] See op. cit. supra note 16.

[18] N.J. Rev. Stat. (1937) tit. 2, c. 29, § 131.

[19] See Shielcrawt v. Moffett, 294 N.Y. 180, 61 N.E. 2d 435 (1945). Here Chief Justice Lehman speaking for the New York Court of Appeals sidestepped the constitutional problems of retroactive application by holding that a statute not in terms retroactive should not be construed as such. The lower court had held Section 61(b) unconstitutional on the basis of its application (as construed below) to pending suits. 49 N.Y.S. 2d 64, aff'd 268 App. Div. 352, 51 N.Y.S. 2d 188 (1944). The court reversed on the ground that the statute was not retroactive, obviously having serious doubts as to the constitutionality of retroactive provisos.

[20] Thus, in the present case the plaintiff was required to post $125,000 with no prospects of real personal gain even in the event of a court victory. Of course, this doesn't preclude the very substantial counsel fees which undoubtedly would still serve as a great incentive to attorneys to instigate derivative actions.

[21] The number of pending actions is necessarily very limited. Consequently, the invalidity of the retroactive provision of the New Jersey statute, if declared, would have no real effect

the Third Circuit in finding for its constitutionality chose to emphasize the statute's role as an implementation of previous remedies against litigious harassment.[22]

RESTRAINTS ON ALIENATION OF STOCK CERTIFICATES

In *Tracey v. Franklin*,[1] two stockholders had placed a majority of shares of class B stock of a Delaware corporation in a voting trust, naming themselves co-trustees. Class B was entitled to elect two of seven directors. The agreement provided that during the trust period of ten years the parties, as depositing stockholders, would not "sell their respective stock so deposited . . . [nor] their respective voting trust certificates . . . nor any interest in the shares of stock represented thereby. . . ."[2] As trustees, they agreed not to sell the stock deposited in trust except upon the consent given and terms stipulated by both depositing stockholders. Upon the death of either party, the survivor was to have an option to purchase the interest of the decedent. No other stockholder was to be admitted into the trust.

In a suit for specific performance by one of the parties, the Delaware Court of Chancery held that the restrictions upon the alienation of the stock interests as represented by the trust certificates were "unreasonable" and nonseparable, and that the entire trust agreement was therefore void.

Although it has been said that in the general field of restraints on alienation, "courts must . . . examine economic and social policy to a greater extent than in many other fields,"[3] the doctrine against restraints on stock transfer has never been explicitly analyzed in the light of the objectives underlying the policy against restraints. Thus, without such analysis, restraints have been invalidated merely on the ground that "the right to transfer is a right of property" and that an unreasonable restraint "amounts to an annihilation of property."[4]

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on the general objectives which it seeks to attain. It would seem particularly harsh to impose these stringent new requirements on plaintiffs who have already changed their position in reliance on the previous derivative suit mechanism.

[22] The Supreme Court, in an opinion published too late for comment in the foregoing note, has affirmed the third circuit court of appeals. Beneficial Industrial Loan Corporation v. Smith, 17 U.S.L. Week 4530 (1949). The majority held that the order denying security could be directly appealed (contra: Aspinook v. Bright, op. cit. note 6); that the statute did not violate substantive due process; and that it represented an important state policy and should consequently apply in federal courts with diversity jurisdiction under the Erie rule as developed in the Angel and York cases. Rutledge, J., in his dissent decried the increasingly broad application of the Erie rule, stating that it was not intended to interfere with federal court procedure.

[1] 61 A. 2d 780 (Del. Ch., 1948). [2] Ibid., at 781.

[3] Manning, The Development of Restraints on Alienation since Gray, 48 Harv. L. Rev. 373 (1935).

[4] Penthouse Properties v. 1158 Fifth Avenue, 256 App. Div. 685, 11 N.Y.S. 2d 417, 422 (1939), citing Fisher v. Bush, 35 Hun. (N.Y.) 641 (1885); cf. People ex rel. Malcom v. Lake Sand Corp., 251 Ill. App. 499 (1929); Searles v. Bar Harbor Banking & Trust Co., 128 Me.