

THE RIGHTS OF STOCKHOLDERS WITH REFERENCE TO THE MANAGEMENT OF A CORPORATION.\*

In the present era of associate enterprise and corporate activity, innumerable questions constantly arise with reference to the relations of a corporation to the state and to individuals; those of the stockholders to each other, to the corporate entity, and to the outside world.

Not the least important of these problems, and one which involves a discussion of many of the theories of the nature of corporate existence and rights, is that which deals with the rights of the stockholders of a corporation to interfere in its management.

May a stockholder go into a law court or court of equity to have his will enforced over that of the directors, or a majority of the stockholders? If so, what amounts to a justification of such action? To what means of accomplishing his end must he resort before calling on the courts to aid him? Are his rights solely against the corporation and its agents, or may he reach the property and interests of outsiders? What is the nature of his cause of action, if any he has, in the case of ultra vires acts? In any case, is his cause of action personal, or has he a right of action arising out of the relation between the corporation and the public represented by the state? Does the contract between the state and the corporation give him any right to object to infringements or alterations of its obligation, when a majority of his associates desire such alterations?

These and kindred questions arise when we attempt to discuss the individual right of a shareholder to intervene in the management of a corporation after having committed such management to certain agents and bodies by his agreement of association.

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Rights of some sort he has; enforceable against his associates and strangers, subject to certain limitations and exceptions. So the courts have decided. The discussion, in some logical order, of these rights of the stockholder, is the purpose of this essay.

It is obvious that in order to discuss the cases intelligently, some theory must be formulated respecting the nature of the relation existing between the corporation and its members.

#### I. THE CORPORATION AND ITS MEMBERS.

A corporation, in the eye of the law, is not identical with the members who compose it. It is a distinct entity, separate from its stockholders; its rights are not their rights, nor its liabilities their liabilities. It exists apart from them. It carries on its business, exercises its functions, and does all its acts as a natural person may. The members, as such, have no voice in its control, in its dealings, or in any of its acts, except through their agents regularly chosen in accordance with the articles of association.

But, reiterate as we will the dogma that the corporation is an entity separate from the members who compose it, we cannot put out of view the fact that, in reality, those members do sustain a very intimate connection with the corporation. And when their rights can be worked out in no other way, the courts will look back of the corporate body, and recognize the existence, within it, of persons who have certain rights, both as regards the other members who compose it, and as regards those persons with whom it has dealt as an entity.

Of what nature are these rights? Substantially those of a partner. The private corporation of to-day is a common-law partnership, however different therefrom its original may have been. True, it is a partnership plus something else. That something else it derives from its charter. It consists of a number of individuals, associated together under circumstances which, had they no grant of power from the sovereign or state, would constitute them a common-law partnership. But the state has recognized the usefulness of such association, and, in view of the advantages to accrue to the public, has encouraged

their formation by grants of charters; thus removing those hardships of the partnership relation,—such as unlimited liability, and power of a single member to bind the associates by any act within the scope of the business,—which would be virtually prohibitive of such aggregation of persons and capital as is necessary to the carrying on of public improvements and large private enterprises. So that, practically speaking, the trading corporation is a common-law partnership plus something more, that something more being the sum of all those rights, immunities, and characteristics which come into being as the result of the act of the sovereign power.

The facts, however, warrant a much broader statement as to the relation of the partnership and the corporation. So intimately are the two connected that we find the tendency of the law of partnership at this day more and more towards the recognition of the firm as an entity apart from its members. Dicta of eminent judges to this effect are numerous. Jessel, M. R., in *Pooley v. Driver*,<sup>1</sup> says, speaking of agency as a test of partnership, "You cannot grasp the notion of agency, properly speaking, unless you grasp the notion of the existence of the firm as a separate entity from the existence of the partners, a notion which was well grasped by the old Roman lawyers, and which was partly understood in the courts of equity before it was *a part of the whole law of the land as it now is.*" To the same effect are *Walker v. Wait*,<sup>2</sup> *Meily v. Wood*,<sup>3</sup> and *Bates on Partnership*, Vol. I., §§ 170–179 incl.

This is to be expected. It is natural that in dealing with problems concerning any associate undertaking, the courts should have turned to that association which was already established in the law for their solution. But the corporation had many features not duplicated in the partnership, and in dealing with these the courts have sometimes slighted the real similarity, which, at bottom, existed between the two.

<sup>1</sup> L. R. 5 Ch. D. 458 (1876).

<sup>2</sup> 50 Vt. 668 (1878).

<sup>3</sup> 71 Pa. 488, 492 (1872).

Vice-Chancellor Wigram, in *Foss v. Harbottle*,<sup>1</sup> one of the leading cases on the subject in England, thus indicates the theory on which the stockholder's right is founded: "Corporations like this, of a private nature, are in truth little more than private partnerships; and in cases which may easily be suggested it would be too much to hold, that a society of private persons associated together in undertakings which, though certainly beneficial to the public, are nevertheless matters of private property, are to be deprived of their civil rights, *inter se*, because, in order to make their common objects more attainable, the Crown or the legislature may have conferred upon them the benefit of a corporate character."

And in the American case of *Pratt v. Pratt*,<sup>2</sup> Hinman, C. J., said: "Joint-stock companies, in modern times, are nothing but commercial partnerships, which have taken the form of corporations for the greater facility of transacting business and to prevent a dissolution of the concern by those numerous events which are so liable to work a dissolution in a partnership composed of a great number of individuals."

Mr. Morawetz<sup>3</sup> justifies the interference of the stockholder on the ground that the corporation is a trustee for the stockholders. As will be pointed out more at length farther on, this theory is unsatisfactory for a number of reasons.

Granting, then, that the stockholder has a right *qua* partner, to interfere in the management of the company by bringing suit to redress corporate wrongs, how may that right be enforced?

## II. SUITS AT LAW.

The courts have uniformly held that the stockholder has no standing in a court of law to enforce either his rights against his fellow-stockholders, the directors, or outsiders, who have wronged the corporation.

And first as to his rights against strangers to the corporation.

<sup>1</sup> 2 Hare, 461 (1843).

<sup>2</sup> 33 Conn. 446 (1866), at p. 456.

<sup>3</sup> Private Corporations, §§ 237-239.

In *Button v. Hoffman*,<sup>1</sup> the plaintiff who was the sole owner of all the shares of stock in a corporation, brought replevin for the corporate property. He was refused a recovery on the ground that his title was not proved, the ownership being in the corporation, and not in the members that composed it.

In *Tomlinson v. Bricklayers' Union*,<sup>2</sup> four hundred members of the Union complained that twenty members had seceded, taken all the funds, refused to give them up, and would not admit plaintiffs to the new Union which they had formed. A demurrer to the complaint was sustained on the ground that no cause of action was shown. It was said that the secession of twenty would not dissolve a corporation of four hundred. The right of action was, therefore, in the corporation and not in the individuals.

The reason for denying the plaintiffs a recovery in such actions as the two cited is quite evident. In all its dealings with the outside world the law treats the corporation as distinct from its members. This is a hard and fast rule of common law courts. So where the question is one of a wrong done to a corporation, it is alone the corporation which may bring the action, just as it would be alone the corporation which could bring an action to recover damages for the breach of a contract between it and an individual. Any other decision would create endless litigation and confusion, not to speak of the violation of principle involved in adopting the separate entity doctrine in one class of actions and discarding it in another.

Now we turn to the cases in which a stockholder brings an action at law against the directors or other stockholders of the corporation.

The leading case in the United States is *Smith v. Hurd*,<sup>3</sup> which was a special action on the case against the directors of a bank for negligently and fraudulently wasting the capital thereof. The court denied a recovery on two grounds :

(a) That there is no legal privity between the directors and shareholders ; the directors are the agents of the corporation,

<sup>1</sup> 61 Wis. 20 (1884).

<sup>2</sup> 37 Ind. 308 (1882).

<sup>3</sup> 12 Metc. (Mass.) 371 (1847).

not of the individuals who compose it ; therefore any action against them must be in the name of the corporation.<sup>1</sup>

(b) " But another important consideration is, that the injury done to the capital stock by wasting, impairing and diminishing its value, is not, in the first instance, nor necessarily, a damage to the stockholders. All sums which could, in any form, be recovered on that ground, would be assets of the corporation, and when collected and received by the directors, receivers, or any other persons entitled to receive the same, they would be held in trust, first to redeem the bills and pay the debts of the bank ; and it would be only after these debts were paid, and in case any surplus should remain, that the stockholders would be entitled to receive anything. It is, therefore, an indirect contingent and subordinate interest, which each stockholder has in damages so to be recovered against the directors."

The above-quoted language shows that a main difficulty in allowing a recovery at law in such cases as this one, is the identical difficulty encountered by a partner who sues his firm at law for similar relief. The stockholder, like the partner, has only a right to profits, after payment of debts, and to the assets which remain after winding up the business. So the court concluded that a stockholder's remedy, if he had any, was in a court of equity, just as a partner's remedy would be, under like circumstances.<sup>2</sup>

A significant case, decided on this principle, is *King v.*

<sup>1</sup>See, also, *Allen v. Curtis*, 26 Conn. 456 (1857) ; *Talbot v. Scripps*, 31 Mich. 269 (1875).

<sup>2</sup>It is not to be understood that the right of the stockholder to sue the corporation at law in certain cases, is questioned in the least by the writer ; for it is too reasonable a doctrine and too well settled to be questioned at this day that he has that right in cases which do not involve his rights as a partner in the undertaking. He may sue as a creditor,—*Pierce v. Partridge*, 3 Metc. (Mass.) 44 (1841) ; and also on notes and bonds, and, on account of the peculiar nature of the corporation, for dividends,—*Hill v. Water Works*, 5 A. & E. 866 ; *Gear v. School Dist.*, 6 Vt. 76 (1834) ; *Sawyer v. M. E. Society*, 18 Vt. 405 (1846) ; *Dunstan v. Glass Co.*, 3 B. & Adol. 125 (1832). It is only when he comes to demand the rights which belong to him in his character as a partner that the law will not allow him to maintain his suit for the reasons stated.

*Governor, Etc., of the Bank of England*,<sup>1</sup> where the King's Bench was moved for a mandamus to the directors of the bank to produce the accounts of the corporation and declare a dividend of the profits.

Abbott, C. J., said : " This is in effect an application on the behalf of one of several partners to compel his co-partners to produce their accounts of profit and loss and to divide their profits if any there be. The examination of the accounts of a trading company may be effectually entered into in the court of chancery ; but this court is a very unfit tribunal for such a subject."

Best, J. : " If we were to grant this rule we should make ourselves auditors to all the trading corporations in England." <sup>2</sup>

The above cases sufficiently illustrate the attitude of common law courts towards actions by a stockholder, and the reasons for their position. The cases have, however, indicated that he has a remedy in equity. Nor is this all. They have intimated that the ground on which equity will take cognizance of such a cause of action is the same as that which underlies a partnership bill.

### III. IN EQUITY.

Perhaps, at first blush, it would seem that equity would brush aside all technicalities and consider the position of the parties without reference to the fact of incorporation, and adjust their rights and administer its remedies accordingly. This, however, it is evident that equity cannot do. There are certain material changes made in the status of the associates by the act of incorporation which a chancellor can no more disregard than can a common law judge. " Equity follows the law " is a maxim quite applicable to the present case. Courts of equity will recognize the separate entity of the corporation and carry it just as far as courts of law, provided no substantial injustice be done. But when injustice would be done by adhering to the strict construction of the law courts, then a chancellor will abandon the legal techni-

<sup>1</sup> 2 B. & Ald. 620 (1819).

<sup>2</sup> See, also, *Pratt v. Pratt*, 33 Conn. 446 (1866).

cality which stands in his way and do justice as between the parties. By this it is not meant that the court will throw all rules to the wind and decide each case on its own facts; but, rather, that it will revert to the relations of the parties, as it finds them, and seek to adjust their rights according to the law which governs that legal relation which their position most resembles. This, in the case of a body of shareholders of a corporation, is the partnership relation. The appropriate action, then, in such cases, is to grant the ordinary partnership remedy subject to such modifications and exceptions as are rendered necessary by the peculiar character of a corporation. So that it is found on looking into the books that a stockholder has a standing, in his individual capacity, in a court of equity, to have certain wrongs peculiar to himself and his interests redressed; subject, however, to certain well-defined rules of procedure and exceptions and limitations arising out of the distinctive character of the association of which he is a member.

Mr. Morawetz<sup>1</sup> founds the right of the shareholder on the theory of a trust. He says: "The relation between a corporation and its several members may, for practical purposes, be treated as that of trustee and *cestui que trust*." He cites in support of this proposition *dicta* of Chancellor Bennett, of Vermont, in *Stevens v. Rutland, &c., R. R. Co.*,<sup>2</sup> and the language of Lord Blackburn in *Taylor v. C. & M. Ry. Co.*,<sup>3</sup> a suit by a third party against a corporation on an alleged illegal contract. He then says that a stockholder may institute his suit, in case the corporation (the trustee) by its officers or by vote of a majority of the stockholders, refuses to protect the corporate rights, or is for any reason unable to do so; on the theory that when a trustee cannot enforce the trust, then, and then only, the *cestui que trust* may sue.

This doctrine seems to be unnecessary to justify the allowance of the action. It is submitted that to base the right on

<sup>1</sup> Law of Private Corporations, Vol. I., p. 231 (2d Ed.).

<sup>2</sup> 29 Vt. 549, 550 (1855).

<sup>3</sup> L. R. 2 Exch. 378 (1867); See, also, *Robinson v. Smith*, 3 Paige, 233 (1832).



a trust relation is objectionable for a number of reasons. In the first place, such a theory is highly artificial. Secondly, it leads to very contradictory conclusions when we come to deal with other problems of corporation law. If the relation is that of a trust for this purpose, then it is a trust for all purposes. If the corporation be a trustee for its members, certainly the corporate assets constitute a trust fund for the stockholders. Yet we know that this latter doctrine, while once asserted by the courts, has been found impracticable and untenable, and has been abandoned. It may safely be said no longer to be law.<sup>1</sup> A trust necessitates a return, at least in part, to the early notion that a corporation is nothing but the sum of the members who compose it. It confuses the status of the stockholder with respect to his corporation by asserting that he has legal rights against it, in the nature of choses in action, as, for instance, on his stock and in addition has the rights of a *cestui que trust* against his trustee. It is believed that the only right which a stockholder has as against the corporation is a strictly legal one. Let us take a practical instance of the inconsistency of such a theory. A corporation is formed for the purpose of holding land. Its property is certainly real estate. Its stockholders are its *cestui que trusts*. Equity follows the law, and the estate of the *cestui que trust* is like in nature to that of his trustee.

It should follow that the stock is in its nature realty. Yet it is well known that the courts have uniformly held, under such circumstances, that the stock is not realty but personalty, in the nature of a chose in action. This result is significant.

But, it will be said, if we have not a trust, on what theory

<sup>1</sup> *Graham v. R. R. Co.*, 102 U. S. 148 (1880), at page 160. Bradley, J. : "It is considered, however, by the appellant that a corporation debtor does not stand on the same footing as an individual debtor ; that, whilst the latter has supreme dominion over his own property, a corporation is a mere trustee, holding its property for the benefit of its stockholders and creditors ; and if it fail to pursue its rights against third persons, whether arising out of fraud or otherwise, it is a breach of trust, and the creditors may come into equity to compel an enforcement of the corporate duty. . . . We do not concur in this view. It is at war with the notions which we derive from the English law with regard to the nature of corporate bodies."

does a court of equity acquire its jurisdiction? The question may be answered by asking another. On what ground will a chancellor interfere at the instance of a partner to restrain the other partners from making away with firm assets? Surely not on the theory of a trust. The reason lies deeper. We may illustrate again by the use of a concrete instance.

In the case of *Hargrave v. Hargrave*,<sup>1</sup> X devised realty to J for life, remainder to J's children as tenants in common in tail. A, by his bill showed that he and B, as the only two children of J, were entitled to the estate. The bill stated the existence of outstanding terms which prevented plaintiff from proceeding at law, and prayed a partition of the estate, an accounting of the moiety of the rents (B having been in possession of the whole), for a receiver and an injunction to restrain the setting up of the outstanding terms. B admitted that he was in receipt of the whole rents. A's prayer was granted by the Master of the Rolls.<sup>2</sup> So it is seen that a court of equity has intervened in the case simply of an injury to joint-property, where there was no adequate remedy at law.

Now turn to the case of a partnership.

A and B buy goods, contrary to the wish of C. C seeks to have the contract set aside in equity. Equity will give no relief. The reason is clear. A, B and C, in order to meet commercial necessity, have introduced the principle of representation. C must be bound by the acts of A with regard to partnership affairs.

But then consider the case where A makes away with the firm assets through fraud, or where a majority of partners defraud a minority. Is the same principle of representation to bar the intervention of a chancellor? The answer to this question is equally clear. So far as the instrumentalities which the partners create for convenience in doing business go, and so far as they are effective to that end, the courts will

<sup>1</sup> 9 Beav 549 (1846).

<sup>2</sup> To the same effect, see *Evelyn v. Evelyn*, 2 Dick, 800 (1750); *Street v. Anderton*, 4 Bro. C. C. 414 ( ); *Williams v. Jenkins*, 11 Georgia, 595 (1820); *Low v. Holmes*, 17 N. J. Eq. 148 (1864); *Blood v. Blood*, 111 Mass. 545 (1872).

respect them. But the moment that the principles of representation and majority control subvert justice, a court of equity will control them in the interest of fairness. In the case of a partnership, a court of equity will not intervene to control these principles until the necessity for intervention is imperative, that is until a dissolution of the relation is demanded. Then equity has power to enjoin, to appoint a receiver, and to order an accounting. You may say, if you will, that the court fastens a trust upon the wrongdoer, but that conveys a meaning very different from the statement that a trust relation subsisted between the parties, which gave the one grounds to complain of the other's acts as being a breach of that trust relation.

Now, turning to the field of corporation law, it is conceived that the same principles apply as in the two instances above cited. The principle of representation will not be disturbed except in the event of injustice being done by adherence thereto. The moment substantial injustice is done, the court allows the stockholder to disregard those agencies he has ordained to represent him, and to bring the suit in his own name. It is believed that it can be shown that this is, in fact, the ground on which the courts have proceeded in the various classes of cases where equity has given the stockholder a hearing.

As has been stated, the rights of the stockholder are not general and unlimited, even where he invokes the aid of chancery. Far oftener is his prayer refused than granted.

Perhaps the clearest method of ascertaining the scope of the jurisdiction of equity will be first to consider under what circumstances and for what reasons the courts have refused to take cognizance of such suits; and then to attempt a classification of the cases in which the courts have granted relief; to which may be added some remarks as to the parties to such actions and the incidental requirements of such procedure.

#### A. CASES IN WHICH EQUITY HAS REFUSED TO INTERFERE.

##### 1. *Acts of a majority within the scope of the business.*

It must be clear, in analogy to partnership, that, within the

scope of the business, the majority is supreme. By his contract of association, the shareholder agrees to be bound by the acts of a majority in the management of the business. This is a matter of private concern, of discretion, and of business skill. In it, the court will not interfere. This is true of partnerships;<sup>1</sup> it is equally true of corporations.<sup>2</sup>

In *Dudley v. Kentucky High School (Supra)*, the object of the corporation was the establishment and maintenance of a high school; it had power "to receive and hold for the benefit of said high school any lands, tenements, etc." The complaint was that land was to be purchased, the price of which the corporation was unable to pay, and that the inevitable result of the purchase would be the bankruptcy of the corporation, and the failure of the project to establish the school. These facts were admitted. It was held that the plaintiff, a stockholder, was entitled to no relief. It was said that, "Each and every stockholder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation; and in cases involving no breach of trust, but only error or mistake of judgment upon the part of the directors who represent the company, individual stockholders have no right to appeal to the courts to dictate the line of policy to be pursued by the corporation."

So, also, in *Treadwell v. Manufacturing Company (Supra)*, it was held that the minority stockholders could not enjoin the dissolution of a private corporation and a sale of all its property to another corporation, payment to be received in the form of shares of stock of the corporation vendee. The court, per Bigelow, J., said: "Neither the public nor the legislature have any direct interest in their business or management. These are committed solely to the stockholders,

<sup>1</sup> *Const. v. Harris, Turn & R.*, 496 (1823); *Blisset v. Daniel*, 10 Hare, 493 (1853); *Zabriskie v. R. R. Co.*, 18 N. J. Eq. at p. 183 (1867).

<sup>2</sup> *Dudley v. Ky. High School*, 9 Bush. (Ky.) 576 (1873); *Treadwell v. Mfg. Co.*, 7 Gray, 393 (1856); *Forbes v. Memphis*, 2 Woods, 331 (1872); *Blackman v. Cent. R. R. Co.*, 58 Ga. 189 (1877); *Agricultural Society v. Gamble*, 52 Iowa, 524 (1879); *Park v. Petroleum Company*, 25 West Virginia, 108 (1884); *In re London and Mercantile Discount Company*, L. R. 1 Eq. 277 (1865); *Smith v. Prattville Manufacturing Company*, 29 Ala. 503 (1857).

who have a pecuniary stake in the proper conduct of their affairs. . . . Public policy does not require them to go on at a loss. . . . If this be not so, . . . the stockholder could be compelled to carry it on until it came to actual insolvency. Such a doctrine is without any support in reason or authority."

The question of the expediency of an act which the corporation may lawfully do will not be inquired into by the courts.<sup>1</sup>

*East Tennessee R. Co., v. Gammon*,<sup>2</sup> is a case which shows how far this rule as to the right of a majority is carried. In that case it was said,—“Admitting, as the fact appears to be, that by a resolution of the company, or board of directors, it was first determined to fix the location of the road by a direct vote of the stockholders; and that in the expectation, and upon the assurance that this mode of locating the road would be carried out, persons were induced to subscribe for stock who would not otherwise have done so; still, it was competent to a majority of the stockholders, by a subsequent resolution, if the general interest of the company . . . seemed to demand it, to change the mode determined upon and adopt a different one.”

So much for suits against a majority. Now as to allegations of misconduct on the part of the directors.

In *Lord v. Copperminers Company*,<sup>3</sup> the court refused to entertain a bill against the directors, because it appeared that their action had been ratified by a vote of a majority of the stockholders. The court took the view that as the stockholders, the partners, were the arbiters of how their business was to be carried on, if they did not disapprove of their agents' acts, and had said so, no one had a right to interfere.

In *Foss v. Harbottle*,<sup>4</sup> the leading English case on this subject, the bill of the stockholder complainant showed that a fraudulent arrangement was concerted between certain parties, including a majority of the directors (a) to buy land from themselves on behalf of the corporation, at great profit to

<sup>1</sup> *Oglesby v. Attrill*, 105 U. S. 605 (1881); *Sims v. Street Ry. Co.*, 37 Ohio St. 556 (1882).

<sup>2</sup> 5 Sneed. (Tenn.) 567 (1858).

<sup>3</sup> 2 Phill. 750 (1848).

<sup>4</sup> 2 Hare, 461 (1843).

themselves, and (b) to negotiate a corporate mortgage thereon to enable the corporation to pay them for the same. Vice-Chancellor Wigram refused to interfere, on the ground that it was a matter of internal management, and that while he was granting the relief, a majority of the stockholders might meet and ratify the acts of the directors, and thus render his decree of no validity.

2. *Where all corporate agencies have not been exhausted.*

But the Vice-Chancellor held another thing, of very great importance, in that case. It was that the corporation was the proper party plaintiff, and, that in order to permit stockholders to sue, he must be shown that they had done all in their power to set the corporation itself in motion to redress whatever wrong had been suffered, and that through the fraud of a majority of the directors, or of the stockholders, or for some other reason, this was impossible. Said he, "It must not be without reasons of a very urgent character that established rules of law and practice are to be departed from, —rules which, though in a sense technical, are founded on general principles of justice and convenience."

In accordance with this, was the later case of *Mozley v. Alston*.<sup>1</sup> In that case it was alleged by the complaining stockholder that twelve out of the eighteen directors were acting beyond their authority, and were not, in point of fact, the legal directors of the company at all; that the majority of the stockholders were in accord with complainant. The court said that if the majority agreed with complainant, there could be no difficulty in bringing a bill in the name of the corporation, and in such case it ought to be so brought. The bill was dismissed.

There is nothing peculiar to corporation law in this rule of jurisdiction as is shown by the case of *Lafond v. Deems*,<sup>2</sup> where the same principle was applied to the case of a voluntary association. That was an action by a member to have the association dissolved. It appeared that the rules of the

<sup>1</sup> 1 Phill. 790 (1847), at p. 800.

<sup>2</sup> 81 N. Y. 507 (1880).

association gave him certain other remedies. It was held that he must apply first to the association under the rules made by that body. "Courts should not as a rule interfere with the contentions and quarrels of voluntary associations so long as the government is fairly and honestly administered, and those who have grievances should be required to resort, in the first instance, to the remedies for redress provided by their rules and regulations."

It is, then, to be gathered from these decisions that, on grounds of convenience, where it is not absolutely impossible, the corporation is to be made the party plaintiff. This will be made clearer, perhaps, by the citation of a partnership case.

In *Natusch v. Irving*,<sup>1</sup> plaintiff, on behalf of himself and others of the shareholders, partners in an unincorporated insurance company, filed a bill to restrain the president from carrying on marine insurance, that not being part of the business as originally mapped out in the contract of association. It was held that his bill was well brought. Lord Eldon said: "To those who know the difficulty of applying the rules of law and equity to societies constituted of such numbers of persons not incorporated, it is not matter of surprise that persons, ignorant of those difficulties, should become members of such societies. . . . Much has been done with respect to the difficulty alluded to, by provisions how those who have demands upon such societies are to sue, and how such societies are to be sued; much remains to be done, and particularly as to rendering simple and effectual the remedies of such societies against each other."

This language shows how sensible of the difficulties and embarrassments of severance of the members, for all purposes, within and without, the society, was Lord Eldon. Now the rule of *Foss v. Harbottle* (*supra*), avoids all multiplicity of suits, avoids all confusion by laying down the broad general doctrine that in every case of injury to one stockholder's interest there is involved *prima facie* a damage to every other stockholder's interest; or, to put it otherwise, to the corporate property at large. Hence, the only just rule is to require the corporation

<sup>1</sup> 2 Cooper (Temp. Cottenham), 358 (1824).

to be made the party plaintiff. But it was recognized in that case that there are some cases which this rule will not reach. As to such cases, it was not doubted that there exists the right to bring an individual action on the part of the stockholder.

This rule has been the subject of so much consideration by the courts, and has been so strictly adhered to, that it should seem that it is incumbent on every plaintiff, in cases like the present, to show: (1) That he is not calling upon the court to settle a question of internal corporate management; and (2) that he has taken his case out of the sphere of internal corporate management by failing, after every possible effort, to compel the corporation and its officers to act.

The language of Lord Justice James, in *Gray v. Lewis*,<sup>1</sup> is striking in view of the language used by Lord Eldon in *Natusch v. Irving*. He says: "One object of incorporating bodies of this kind was, in my opinion, to avoid the multiplicity of suits which might have arisen where one shareholder was allowed to file a bill on behalf of himself and a great number of other shareholders. The shareholder who first filed the bill might dismiss it, and, if he was a poor man, the defendant would be unable to obtain his costs, then another shareholder might file a bill and so on. It was also stated to us in the course of the argument that even after the plaintiff had dismissed his bill against a particular defendant, a fresh bill might be filed against the defendant so dismissed. Therefore there might be as many bills as there are shareholders multiplied into the number of defendants. The result would be fearful, and I think the defendant has a right to have the case made against him by the real body which is entitled to complain of what he has done.

The two last cases taken together show the real substantive agreement between the partnership and the corporation, and the mere formal difference in the method of working out the rights of the associates.

*McDougal v. Gardiner*<sup>2</sup> is authority for the proposition that

<sup>1</sup> L. R. 8 Ch. App. 1035 (1873).

<sup>2</sup> L. R. 1 Ch. D. 13 (1875).



where there is an oppressive act done by directors and stockholders, and there is no mode of determining who is in the majority, because the vote is not taken in accordance with the articles, then the proper procedure is for the complaining stockholders to file a bill in the name of the company; whereupon the court will take measures to determine which party is in the majority. "If the company thinks that any shareholder has anything which ought to be made the subject of complaint, there is never any difficulty whatever arising from the apparent possession of the seal by the directors, or from any such cause, in filing a bill in the name of the company, if the majority of the company desire it to be filed. . . . Of course, if the majority are abusing their powers and are depriving the minority of their rights, that is an entirely different thing."

Complainant must therefore show, not only that the directors have been appealed to, but also that some effort has been made to hold or call a meeting of the stockholders.<sup>1</sup>

Some idea of the strictness with which the rule is enforced may be gathered from the language of Van Vorst, J., in *Allen v. R. R.*<sup>2</sup> "Its (the corporation's) omission to elect officers, the sale of its property and assets, its failure to transact business, and the other facts in regard to it as alleged, do not work a dissolution of the corporation," so that a suit may be brought in the stockholders' names and not in that of the corporation. "In order to work a dissolution, there must have been a surrender of its charter to, and an acceptance by, the state, or there must have been a judgment of dissolution rendered by a court of competent jurisdiction."

In *Hazard v. Durrant*,<sup>3</sup> Durfee, C. J., said: "The allegation in the bill is simply an allegation of a request to the corporation, without particularizing how or when it was made. The allegation will be sustained by proof of a request to the stock-

<sup>1</sup> *Newby v. Oregon Ry. Co.*, 1 Sawy. 63 (1870); *Greaves v. Gouge*, 69 N. Y. 154 (1877); *Robinson v. Smith*, 3 Paige, at p. 232 (1832); *Bill v. W. U. Tel. Co.*, 16 Fed. 14 (1883); *Holton v. Newcastle Ry. Co.*, 138 Pa. 111 (1890); *Cogswell v. Bull*, 39 Cal. 320 (1870).

<sup>2</sup> 49 Howard Practice, 14 (1875).

<sup>3</sup> 11 R. I. 195 (1875), at p. 203.

holders in corporate meeting or to the directors in office when the suit began, or in any other mode so as to be in legal effect a request to the corporation."

It is submitted that this language, though such as is often found in the reports, is not broad enough, as is shown by the case of *Dunphy v. Traveller Association*.<sup>1</sup>

In that case it was said: "In the case at bar there is an averment that . . . the alleged wrongdoer has for a long time controlled a majority of the stock and has elected such persons directors as he choose. That states a sufficient reason for not applying to the corporation at a meeting of its members, for action to redress its wrong. But it is not alleged that the plaintiff ever attempted to move the directors in the interest of the corporation, in the matters complained of, or that any good reason existed for his failure so to do.

. . . . There are no allegations of fraud or . . . misconduct on the part of any of them. And it cannot be presumed in the absence of such averments that they would refuse to do their duty if their attention were called to it."

This results in the doctrine that it is not sufficient to show either an application to a corporate meeting alone, or to the directors alone; both bodies must be appealed to before the stockholder has any standing to sue in his own name. In another case, the complainants showed that they had tried to have their wishes carried out by a meeting of the stockholders and failed, but neglected to aver that they had applied to the directors. The bill was dismissed.<sup>2</sup>

Tested by the principles just stated, the case of *Bailey v. Citizens' Gas Light Company*<sup>3</sup> seems to have been wrongly decided. The facts in that case were that the A corporation and the B corporation entered into negotiations looking to their consolidation. The A company agreed to purchase the stock of the B company at a valuation, it to be paid for in stock of the A company at a valuation. The consolidation

<sup>1</sup> 146 Mass. 495 (1888), at p. 498; See, also, *Mfg. Co. v. Cox*, 68 Ala. 71 (1880).

<sup>2</sup> *Memphis City v. Dean*, 8 Wall. 65 (1878).

<sup>3</sup> 27 N. J. Eq. 196 (1876).

was authorized by an act of the legislature. The B company represented that its indebtedness amounted to a certain sum only. Pending negotiations, and after this representation, the directors of the B company issued a script dividend which, of course, was a fraud upon the stockholders of the A company. After the consolidation M and N, two stockholders of the A company, discovering the fraud brought their bill to have the said dividends refunded. The prayer was granted.

It is submitted that there is no good reason why the injury to the two stockholders in question was not also an injury to all the stockholders in the A company. It follows that the bill should have been brought in the name of that company, no reason being alleged why it was impossible so to bring it.

On a parity of reasoning, the case of *Taylor v. Miami Exporting Company*<sup>1</sup> would seem to be unsound. In that case the bill was against the directors and certain individual stockholders alleging fraudulent acts on their part, which caused a suspension of the business and the depreciation in value of the capital stock. In the absence of any allegation that either the directors or a majority of the stockholders refused to right plaintiff's wrong, he was allowed to maintain his bill in his own name.

*Owen J. Roberts.*

(To be continued.)

<sup>1</sup> 5 Ohio, 162 (1831).