VERIFICATION OF COMPLAINT IN STOCKHOLDERS' DERIVATIVE SUITS UNDER RULE 23(b)

Verification of pleadings has in most situations been abolished by the Federal Rules of Civil Procedure.[1] One situation in which it has been retained[2] is rule 23(b), which requires that the complaint in a stockholders' derivative suit be "verified by oath."[3] The rule itself gives no indication of the reason for retention of verification in this isolated instance, nor has the requirement been interpreted by judicial decision. Important questions concerning the basic purpose for the rule were raised by a recent case, *Surowitz v. Hilton Hotels Corp.*,[4] in which the Court of Appeals for the Seventh Circuit was called upon to decide the extent to which the plaintiff in a derivative suit must be personally familiar with the factual basis of his complaint in order to make a valid verification of it within the meaning of the rule. The plaintiff, an immigrant seamstress with little education and only a limited command of the English language, brought suit on the advice of her son-in-law and financial advisor, Irving Brilliant. In her complaint she charged violations of the federal securities laws,[5] as well as of the general corporation law of Delaware. In substance she alleged a series of fraudulent transactions whereby the corporation had been caused to purchase, at an artificially inflated price, shares of stock belonging to the individual defendants, who were officers and directors of the corporation. The plaintiff attached her verification to the complaint.[6] On deposition, some two and one-half months after the filing of the complaint, the plaintiff was asked on what basis she had made various allegations of the complaint. In each instance she replied that she did not understand or had no knowledge of the facts. The defendants moved to dismiss the complaint on the basis of this deposition, claiming that it showed she had made a false verification. The court of appeals affirmed the district court's

[1] See FED. R. CIV. P. 11.

[2] Verification of pleadings is expressly required in two other situations under the federal rules: 1) where a petition for a deposition to perpetuate testimony is filed prior to the commencement of suit, FED. R. CIV. P. 27(a)(1); and 2) in support of a motion for a temporary restraining order, FED. R. CIV. P. 65(b). In addition, FED. R. CIV. P. 66 provides that in proceedings for appointment of a receiver, the practice "shall be in accordance with the practice heretofore followed" in the federal courts. Earlier practice seems to have required verification of pleadings. Clark v. Brown, 119 Fed. 130, 132 (8th Cir. 1902) (dictum); 2 MOORE, FEDERAL PRACTICE ¶ 11.03, at 2106 n.6 (2d ed. 1964). For an enumeration of other situations in which verification is required by federal statutes, see *Verification and Certification of Pleadings*, in N.Y. TEMPORARY COMM'N ON THE COURTS: REP. 269, 284-85 (1957).

[3] FED. R. CIV. P. 23(b).

[4] 342 F.2d 596 (7th Cir.), *cert. granted*, 86 Sup. Ct. 42 (1965).

[5] Securities Exchange Act of 1934, §§ 9(a)(4), 9(e), 10(b), 48 Stat. 889, 15 U.S.C. §§ 78i(a)(4), 78i(e), 78j(b) (1964); Securities Act of 1933, §§ 12(2), 17(a), 48 Stat. 84, 15 U.S.C. §§ 77*l*, 77q(a) (1964).

[6] Certain allegations of the complaint were sworn to as "true," and the rest were verified "upon information and belief." 342 F.2d at 600.

dismissal of the complaint on this ground, holding that the plaintiff had failed to comply with rule 23(b). The court found as a minimum requirement of the rule that the plaintiff must have a general knowledge of the acts complained of and the connection of the defendants to those acts, and held that the plaintiff's failure to give satisfactory answers to the questions propounded to her on deposition evidenced a failure of compliance with that "minimum requirement." [7]

The court did not find that the plaintiff had sworn to the truth of allegations which she knew, or had reason to know, were false. Nor did the court's holding rest upon any determination that the allegations were in fact false or unfounded. The court found merely that the plaintiff was without any knowledge or understanding of the basic allegations of her complaint.[8] This result and the reasoning which supports it, mistake both the purpose of rule 23(b)'s verification requirement and the role of the plaintiff in a derivative suit.

It is possible to interpret this decision broadly as holding that in every derivative suit the plaintiff has a special duty to understand, and be familiar with, the factual basis of his claim.[9] If indeed this is the court's holding, it ignores the limited nature of the role played by the plaintiff in a derivative suit. Though conceding that the plaintiff in a derivative suit is primarily "the instrument through which the judicial machinery is set in motion," [10] the court apparently felt that he must be an active, rather than a passive instrument.[11] But it seems unrealistic to expect, and unreasonable to demand that in every derivative suit the plaintiff will have even a basic familiarity with the factual basis of his claim. In derivative actions, perhaps more than in other types of suits, the plaintiff must rely heavily on

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[7] *Id.* at 608.

[8] *Id.* at 607.

[9] The court declined to express an opinion on the question whether verification by the plaintiff's attorney would satisfy the rule. *Ibid.* Although the validity of an attorney's verification was not in issue in *Surowitz* because no such amended verification was offered, the absence of any dictum that such verification *could* satisfy rule 23(b) at least raises the possibility that the court's holding extends to a determination of what may be demanded of the plaintiff in every derivative suit. One court has expressed the opinion that there is nothing in the rule that would require the complaint to be verified by the plaintiff rather than his attorney. Bosc v. 39 Broadway, Inc., 80 F. Supp. 825, 827 (S.D.N.Y. 1948) (dictum) (in ruling on a proposed settlement the court set forth the opinion which had been written prior to the offer of settlement).

[10] 342 F.2d at 608.

[11] "[I]t affirmatively appears that plaintiff merely loaned her name to a suit which others desired to file, though she had no idea what the suit was all about." *Id.* at 607. If the court meant by this statement to suggest that the plaintiff had, either intentionally or unintentionally, agreed to participate in a "strike suit," it failed to demonstrate any basis for the conclusion. The degree of the plaintiff's understanding of her complaint would seem to be an unreliable indicator of her motives in bringing suit. The plaintiff's ignorance, it is true, demonstrates that she relied almost wholly on her advisor's judgment, and probably played a very small part in the decision to bring suit. If this is an evil at all, it would seem that it is an evil that must be endured if unsophisticated stockholders such as Mrs. Surowitz are ever to be afforded the right to sue derivatively.

advice and information given him by his attorney.[12] Even a very experienced and knowledgeable investor may have to rely on his attorney to provide the most intricate factual details of his claim;[13] a less sophisticated plaintiff may know no more than that he has missed a dividend or that he has been solicited with regard to some proposed corporate action.[14] Unless this latter class of stockholders is simply to be denied altogether the privilege of bringing suit in a derivative capacity, it would not seem that a broad reading of the court's holding can be supported.[15]

[12] In many cases the attorney is not only the source of most of the information on which the decision to bring suit is based, but is also the person with the greatest interest in seeing that the alleged corporate right or claim is enforced. In class suits the primary motivation for bringing suit often belongs to the attorney rather than the individual member or members of the class in whose name suit is brought. Where the individual interest of each member of the class is too small to justify the trouble and expense of litigation, the attorney may be the *only* person with an incentive to bring suit. See Kalven & Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684, 715, 718-20 (1941). In a derivative suit, the successful plaintiff is uniformly entitled to receive compensation from the corporation for litigation expenses. LATTIN, CORPORATIONS 381 (1959). Even so, there is very little incentive for the small stockholder to take the trouble to bring suit, and to subject himself to considerable expense if he loses. Hornstein, *The Counsel Fee in Stockholders' Derivative Suits*, 39 COLUM. L. REV. 784, 792-93 (1939). Thus the attorney who brings suit on a contingent fee basis may be the only person with a sufficient "interest" to enforce the corporate cause of action. LATTIN, *op. cit. supra*, at 381; Hornstein, *supra* at 793. Since the plaintiff will be reimbursed, and the attorney will thus get his fee only if the corporation is deemed to have been benefited by the suit, there seems to be little reason in principle why such arrangements should be discouraged. The chief dangers are 1) that ambitious attorneys will stir up unwarranted litigation, thus harassing corporations and their directors, and 2) that such self-interested litigants will seek secret settlements which do not benefit the corporation. FED. R. CIV. P. 23(c)'s prohibition of private settlements is designed specifically to curtail this latter sort of activity. BALLANTINE, CORPORATIONS ¶ 152, at 363 (rev. ed. 1946). And a suit which is frivolous or without foundation in fact may be attacked by a motion for summary judgment, FED. R. CIV. P. 56, or a motion to strike the complaint as sham, FED. R. CIV. P. 11.

[13] See Murchison v. Kirby, 27 F.R.D. 14, 18-19 (S.D.N.Y. 1961).

[14] In *Surowitz*, the plaintiff received a letter from the corporation setting forth the terms of the proposed stock purchase. The plaintiff turned this letter over to her son-in-law and advisor, Mr. Brilliant, who then initiated the investigation which eventually led to the institution of suit. 342 F.2d at 601.

In many cases, of course, the problem of the plaintiff's lack of familiarity with the complaint may be alleviated if he is properly prepared as a witness by his attorney. But there are some stockholders who are simply incapable of comprehending even the basic elements of a complex cause of action. The court in *Surowitz* found that the "plaintiff is among the most unsophisticated of investors," 342 F.2d at 606, and that she was "wholly lacking in sophistication in financial matters." *Id.* at 607. The record showed that the complaint had been read to the plaintiff before she signed it, though, as the court pointed out, "it seems obvious from her deposition that she had no conception of the matters read." *Ibid.* The complaint was quite complex, contained eleven counts, and covered ninety-one pages. See Appendix to Brief for Plaintiff-Appellant. The nature of the violations charged was such that only a person with a fair understanding of corporate affairs would have been able to grasp the events and issues in question. See 342 F.2d at 599.

[15] The criticism that a given class of stockholders is unduly discriminated against has also been leveled at the state "security for expenses" statutes, which require that security for the expenses of the corporation and individual defendants be posted in cases where the plaintiff holds less than a stated percentage of the total outstanding stock of the corporation. Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 32 CALIF. L. REV. 123, 143 (1944). But at least such statutes have been based upon a legislative determination that there was some relationship between the criterion used (percentage of stock owned by the plaintiff) and the probable motives of the plaintiff in bringing suit. See WOOD, SURVEY AND REPORT

Since the court was not called upon to rule on the question whether the plaintiff's attorney might have substituted his verification for that of the plaintiff,[16] a narrower interpretation of its holding is possible. Under this view of the decision, the plaintiff's verification was defective not because there is a duty generally imposed on plaintiffs in derivative suits to be knowledgeable, but simply because she, as the person verifying, was not sufficiently well informed to make a judgment as to the validity of the allegations. The court found that the purpose of the verification requirement is to prevent the corporation and its directors from being harassed by frivolous suits and evidently felt that this purpose would be defeated if the person verifying the complaint did not have at least a basic understanding of what was alleged.[17] It is arguable that such a result is necessary, if the purpose of the verification requirement is to guard against sham pleadings—and that no particular hardship is imposed by so holding, since an unsophisticated plaintiff may have the attorney verify in his stead.

Even under this rationale, however, it is questionable whether there is any justification for dismissing the complaint in the absence of a showing that the allegations are in fact false or sham. The court in *Surowitz* admitted that "many of the material allegations of the complaint are obviously true and cannot be refuted." [18] It also appeared that plaintiff's attorneys had conducted a "substantial and diligent investigation" before filing the complaint.[19] Under these circumstances, it is not clear that the plaintiff's lack of comprehension should be grounds for dismissal of the complaint. The purpose of the rule may, however, be preventive, and the burden of showing that the allegations are in fact false or sham should perhaps not be cast upon the defendants.[20]

REGARDING STOCKHOLDERS' DERIVATIVE SUITS (1944). See also Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 548 (1948). The findings of the Wood report, on the basis of which the New York statute was passed, have, however, been severely criticized. Ballantine, *Abuses of Shareholders' Derivative Suits: How Far Is California's New "Security for Expenses" Act Sound Regulation?*, 37 CALIF. L. REV. 399, 416-17 (1949); Hornstein, *supra*, at 143-45.

[16] See note 9 *supra*. By leaving the question open, the court's opinion is susceptible to both interpretations: 1) only the plaintiff may verify, and therefore all stockholder plaintiffs must meet the "knowledge" test; 2) either the plaintiff or his attorney may verify, depending upon who is familiar with the facts.

[17] See 342 F.2d at 606.

[18] *Id.* at 607.

[19] *Ibid.*

[20] "A pleading may . . . be sham in respects other than the lack of an arguable foundation to sustain it . . . . [A] pleading governed by Rule 23(b) is sham when it clearly appears that the ostensible verification is a mere formality without knowledgeable . . . comprehension in the party plaintiff whose verification gives it the breath of life." *Ibid.*

The theory that a pleading may be stricken as sham regardless of whether the allegations are shown to be false or unfounded where it appears that the attorney signed the complaint without any basis for believing the allegations to be true, has been applied to rule 11's certification provision. Freeman v. Kirby, 27 F.R.D. 395, 399 (S.D.N.Y. 1961). In *Surowitz*, however, the court conceded that there was no basis for striking the complaint under rule 11. 342 F.2d at 607. The court's contention would seem to be, therefore, that *both* the plaintiff and the attorney must be informed with regard to the factual basis of the complaint. *Cf.* Murchison v. Kirby, 27 F.R.D. 14 (S.D.N.Y. 1961), in which the plaintiff's attorney had conducted a

A more basic criticism of the court's holding goes to its primary assumption that the purpose of the verification requirement is to guard against sham pleadings. It is difficult to reconcile this notion of the purpose of rule 23(b)'s verification requirement with the existence in rule 11 of a certification provision which appears to serve precisely the same function. Rule 11 requires that all pleadings be signed by an attorney of record and provides that the attorney's signature constitutes a "certificate by him that he has read the pleading," and that "to the best of his knowledge, information, and belief there is good ground to support it . . . ." For a "wilful" violation of the rule, the attorney may be "subjected to appropriate disciplinary action,"[21] and if the attorney fails to sign a pleading, or if it is signed "with intent to defeat the purpose of the rule, it may be stricken as sham and false . . . ." A pleading is "sham" within the meaning of the rule if it is filed by an attorney who has an inadequate basis for believing that there is good ground to support the allegations, regardless of whether they are in fact false, or whether he knows them to be false.[22] Rule 11 thus provides ample protection against frivolous pleading, the prevention of which the court in *Surowitz* saw as the primary purpose of rule 23(b)'s verification provision.

Rule 11 does not require that the allegations be true—it merely requires that the attorney who signs the pleadings have a reasonable belief in their validity.[23] With regard to the bulk of the allegations—those which set forth plaintiff's "substantive" claim—it would clearly be unreasonable to demand anything more than this, since the attorney's knowledge of the facts underlying the plaintiff's claim must necessarily be incomplete and second hand to some degree.[24] Furthermore, there is no compelling necessity for an absolute assurance of the truthfulness of these

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substantial investigation, and defendant's motion to dismiss under rule 11 was therefore denied, despite plaintiff's lack of personal familiarity with the factual basis of the complaint. The case is distinguishable from *Surowitz* on the ground that the plaintiff had an understanding of the basic allegations of his complaint, though not of all the detailed, technical facts.

[21] Such disciplinary action against an attorney appears to be taken only rarely. In American Auto. Ass'n v. Rothman, 104 F. Supp. 655 (E.D.N.Y. 1952), the court ordered its opinion to be cross indexed against the attorney's name for future reference in case of further violations. In *In re* Los Angeles County Pioneer Soc'y, 217 F.2d 190 (9th Cir.), *reversing sub nom. In re* Lavine, 126 F. Supp. 39 (S.D. Cal. 1954), the order of the district court disbarring an attorney for wilful violation of rule 11 was reversed by the court of appeals on the ground that the lower court had no jurisdiction to order disbarment where the attorney had not been afforded notice of the charges against him, or an opportunity to defend.

[22] Freeman v. Kirby, 27 F.R.D. 395 (S.D.N.Y. 1961) (attorney apparently copied complaint filed against the same defendant by another plaintiff).

[23] The rule provides that the pleading may be stricken when it is signed with *intent* "to defeat the purpose of the rule," and the attorney may be disciplined only if his violation is *"wilful."* But note that the attorney's belief must be reasonable, and the court may inquire into the adequacy of the grounds upon which that belief is based. Freeman v. Kirby, *supra* note 22.

[24] Palmer v. Morris, 316 F.2d 649 (5th Cir. 1963) (verification "on information and belief" sufficient under rule 23(b)); see *id.* at 650.

allegations at the time suit is filed.[25] It would seem, then, that with regard to most of the allegations of the complaint, if verification is required at all, the most that may be demanded is that they be sworn to to the best of the affiant's "information and belief." It would be reasonable to require such a verification, since, like certification, it would put in issue only the affiant's belief in the truthfulness of the allegations—and, perhaps, the reasonableness of that belief. The question is whether such a verification serves any purpose beyond that served by rule 11's certification provision and whether it may therefore be said to have been within the intention of those who drafted the federal rules.

Of course the addition of the verification requirement provides a further sanction beyond those provided by rule 11—prosecution for perjury—to induce adherence to the standard of good faith pleading. It may also provide an additional psychological deterrent to false pleading, in that it sets stockholders' derivative suits apart from other actions and indicates a special need for truthfulness in the former. It seems doubtful, however, that the draftsmen of the rules provided for verification in the case of derivative suits solely for these very limited purposes. The very reason for discarding verification and replacing it with certification by the attorney, was that the latter was thought to be a more effective means of insuring truthfulness in pleading.[26] It seems much more likely that the draftsmen included a verification requirement in rule 23(b) in order to insure not merely that the verified allegations are pleaded in good faith, but that they are in fact true—that is, the draftsmen intended a different *standard* to apply. With regard to most of the allegations of the complaint, however, it would not be reasonable to require anything more than that they be pleaded in good faith.[27] But with regard to certain other allegations of the complaint, there may exist a special need to insure at the time suit is filed that the facts alleged are true and to that end to impose a standard of truthfulness higher than that demanded by rule 11. The draftsmen of the rules may well have intended the application of the verification requirement to be limited to these allegations.

Rule 23(b) requires that every complaint in a derivative suit must aver:

> (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved

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[25] The defendant may, of course, test the factual basis of any allegation prior to trial by a motion for summary judgment, under FED. R. CIV. P. 56. *E.g.*, Brooks v. Utah Power & Light Co., 151 F.2d 514 (10th Cir. 1945); Wise v. Universal Corp., 93 F. Supp. 393 (D. Del. 1950).

[26] PROCEEDINGS OF THE WASHINGTON INSTITUTE ON THE FEDERAL RULES 52 (Hammond ed. 1939) (remarks of Judge Clark). It seems that verification was a most ineffective means for insuring truthfulness in pleading, due partially to the clumsiness of the method for punishing violations. For a discussion of New York's experience with perjury prosecutions for false verification, see *Verification and Certification of Pleadings*, in N.Y. TEMPORARY COMM'N ON THE COURTS: REP. 269, 280-82 (1957).

[27] See text accompanying notes 24-25 *supra*.

> on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

The complaint must also

> set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

These requirements were first laid down in *Hawes v. Oakland*,[28] and were at least in part the Supreme Court's response to a rapid growth of collusive practices engendered by an earlier decision, *Dodge v. Woolsey*,[29] which had held that a nonresident stockholder could bring a derivative action in a federal court on the basis of diversity of citizenship, to enjoin the payment of an allegedly illegal tax, where the defendants—the tax authorities, the corporation, and its directors—were all citizens of the same state.[30] As a result of this decision, the derivative suit became a convenient and frequently utilized device through which corporations gained entrance into the federal courts, for the purpose of litigating disputes with parties who were citizens of the same state.[31] The Court sought to relieve the burden thus imposed on federal district courts by requiring that the complaint contain an allegation that the suit was not collusive. But the allegation itself would merely make the presence or absence of collusion a litigable issue, and the court would still have to deal with the case until such time as evidence could be taken. The verification requirement, therefore, forces the plaintiff to swear to the truth of the required allegation before his com-

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[28] 104 U.S. 450 (1881). The rule was adopted virtually verbatim as Equity Rule 94 at the same term in which *Hawes* was decided; it then became Equity Rule 27, and was incorporated into the federal rules with minor word changes. Supplementary Note of Advisory Committee, FED. R. CIV. P. 23(b); 3 MOORE, FEDERAL PRACTICE ¶ 23.15(1) (2d ed. 1964).

[29] 59 U.S. 331 (1855).

[30] At the time Dodge v. Woolsey, 59 U.S. 331 (1855), was decided, federal courts were not authorized to dismiss an action because of collusion in creating federal diversity jurisdiction. Moreover, since prior to 1875 there was no general "federal question" jurisdiction in the district courts, corporations which were not federally incorporated could not challenge the constitutionality of state statutes in federal courts except where diversity of citizenship existed. 3 MOORE, FEDERAL PRACTICE ¶ 23.15(1), at 3491 (2d ed. 1964). The Act of March 3, 1875, 18 Stat. 472 (now 28 U.S.C. § 1359 (1964)), gave district courts jurisdiction over "federal question" cases and directed that the court should not accept jurisdiction over any action in which it appeared that there had been collusion for the purpose of creating federal jurisdiction.

[31] 3 MOORE, FEDERAL PRACTICE ¶ 23.15(1), at 3492 (2d ed. 1964). "This practice has grown until the corporations created by the laws of the States bring a large part of their controversies with their neighbors and fellow-citizens into the courts of the United States for adjudication, instead of resorting to the State courts, which are their natural, their lawful, and their appropriate forum." Hawes v. Oakland, 104 U.S. 450, 452 (1881).

plaint can even be filed, with the aim of keeping collusive suits out of the federal courts.

The two other requirements laid down in the *Hawes* case—ownership of stock contemporaneous with the transactions complained of and demand or protest to the directors prior to the institution of suit—have also been regarded as provisions designed to prevent collusive establishment of diversity jurisdiction.[32] To the extent that this is true, positive verification of these two allegations is necessary for the same reason that the allegation denying collusion must be verified. But the courts have not regarded the prevention of collusion to be the only function served by the two provisions.[33] Another purpose which they have assigned to the contemporaneous ownership requirement is the elimination of speculation in lawsuits by preventing stockholders from acquiring their shares with a view toward bringing suit.[34] The rule has also been said to rest on a general equitable principle that a stockholder is estopped to challenge actions taken by the corporation prior to his ownership of shares.[35] The prior

[32] The Court in *Hawes* was evidently concerned about the possibility that the directors, being unable to find a nonresident stockholder to serve as plaintiff, might transfer shares to some citizen of another state who would then bring suit. *Id.* at 453. Similarly, the Court sought to insure that there was in fact a conflict between the plaintiff stockholder and the directors by requiring the plaintiff to make "an earnest, not a simulated effort" to induce remedial action on the part of the directors, thus reducing the probability that there had been collusion between them. *Id.* at 461. Supreme Court decisions immediately following the *Hawes* case suggest that prevention of collusive practices in artificially creating diversity jurisdiction was the purpose of the prior demand and contemporaneous ownership requirements, as well as the requirement of an allegation denying collusion. City of Quincy v. Steel, 120 U.S. 241 (1887) (both provisions); Detroit v. Dean, 106 U.S. 537 (1882) (prior demand); Huntington v. Palmer, 104 U.S. 482 (1881) (prior demand). *But see* Dimpfell v. Ohio & Miss. R.R., 110 U.S. 209 (1884). A number of cases holding the contemporaneous ownership provision inapplicable where federal jurisdiction rested on some ground other than diversity of citizenship support the view that the purpose of the provision is to prevent collusion in manufacturing diversity jurisdiction. Jablow v. Agnew, 30 F. Supp. 718 (S.D.N.Y. 1940); Jacobson v. General Motors Corp., 22 F. Supp. 255, 258 (S.D.N.Y. 1938) (court followed earlier precedents, but expressed the view that the distinction between cases removed from state courts on the basis of diversity of citizenship and those removed on the basis of federal question was an "anomaly"); Hand v. Kansas City So. Ry., 55 F.2d 712 (S.D.N.Y. 1931). For cases expressing a contrary view—that the prior demand and contemporaneous ownership provisions are applicable regardless of the basis of the court's jurisdiction —see note 33 *infra*.

[33] The prior demand provision has been held applicable in federal question as well as diversity cases, although it would not seem that the problem of collusion would arise in the former context. Wathen v. Jackson Oil & Ref. Co., 235 U.S. 635 (1915); see Jacobson v. General Motors Corp., *supra* note 32, at 257 (dictum). The contemporaneous ownership provision has also been held applicable in a case in which the court had original jurisdiction based on a federal question. Gottesman v. General Motors Corp., 28 F.R.D. 325 (S.D.N.Y. 1961), *cert. denied*, 379 U.S. 882 (1964) (limited the principle of the *Hand, Jablow,* and *Jacobson* decisions, *supra* note 32, to removed cases).

[34] Dimpfell v. Ohio & Miss. Ry., 110 U.S. 209 (1884); Gottesman v. General Motors Corp., *supra* note 33; Home Fire Ins. Co. v. Barber, 67 Neb. 644, 658, 93 N.W. 1024, 1029-30 (1903) (dictum).

[35] Home Fire Ins. Co. v. Barber, *supra* note 34; 3 MOORE, FEDERAL PRACTICE ¶ 23.15(2), at 3494-96 (2d ed. 1964); see Venner v. Great No. Ry., 209 U.S. 24 (1908). Simply because the rule is not exclusively aimed at protecting the district courts from impositions on their diversity jurisdiction, however, does not mean that the rule has any effect broader than the "procedural" one of defining the right of the individual

demand requirement is intended to insure that the directors or majority stockholders have been given ample opportunity to bring suit in the corporate name, or take other remedial action, before a minority stockholder may be permitted to challenge their failure to do so.[36] The rationale seems to be that the proper place for the settlement of disputes is within the corporation and resort may not be had to the courts until it is certain that all other remedies have failed, or would be futile.[37] It is evident, then, that the contemporaneous ownership and prior demand requirements constitute conditions precedent to the institution of a derivative suit which

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stockholder to act as plaintiff. Failure of compliance with the contemporaneous ownership provision is not a bar to the right of other stockholders to bring suit. Truncale v. Universal Pictures Co., 76 F. Supp. 465 (S.D.N.Y. 1948); Perrott v. United States Banking Corp., 53 F. Supp. 953, 956 (D. Del. 1944); Pikor v. Cinerama Prod. Co., 25 F.R.D. 92, 95 (S.D.N.Y. 1960) (dictum). See also Bauer v. Servel, Inc., 168 F. Supp. 478 (S.D.N.Y. 1958); Hirshhorn v. Mine Safety Appliance Co., 101 F. Supp. 549 (W.D. Pa. 1951), *aff'd*, 193 F.2d 489 (3d Cir. 1952) (cases holding contemporaneous ownership provision applicable to intervening stockholders).

Professor Moore contends that since no other qualified shareholder may be willing to bring suit, the right of the corporation may *effectively* be barred by a decision under rule 23(b) adverse to the stockholder plaintiff. Hence the contemporaneous ownership provision is "substantive" and should not be held applicable in diversity cases where state law imposes no such requirement. 3 MOORE, FEDERAL PRACTICE ¶ 23.15(2), at 3499-3500 (2d ed. 1964). The federal courts have generally not followed this reasoning. H F G Co. v. Pioneer Pub. Co., 162 F.2d 536 (7th Cir. 1947); Kaufman v. Wolfson, 136 F. Supp. 939 (S.D.N.Y. 1955); Piccard v. Sperry Corp., 36 F. Supp. 1006, 1010 (S.D.N.Y.), *aff'd per curiam*, 120 F.2d 328 (2d Cir. 1941); Cohen v. Beneficial Industrial Loan Co., 337 U.S. 541, 556 (1949) (dictum). *Contra*, Fuller v. American Mach. & Foundry Co., 95 F. Supp. 764 (S.D.N.Y. 1951).

[36] "Resort to the courts through the extraordinary means of a derivative suit, therefore, cannot be made until it is certain that the ordinary means of relief have failed—that is, until it is certain that the directors and shareholders have had an opportunity of deciding to sue, unless it is unreasonable to expect such a decision." Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73 HARV. L. REV. 746, 748 (1960). The prior demand requirement is frequently stated in terms of exhaustion of intracorporate remedies prior to the institution of suit. Hawes v. Oakland, 104 U.S. 450, 460-61 (1881); Lucking v. Delano, 129 F.2d 283, 286 (6th Cir. 1942); Gunn v. Voss, 154 F. Supp. 345, 346 (D. Wyo. 1957); Maxwell v. Enterprise Wall Paper Mfg. Co., 47 F. Supp. 999, 1001 (E.D. Pa.), *rev'd on other grounds*, 131 F.2d 400 (3d Cir. 1942). Where the plaintiff alleges fraud or wrongdoing on the part of the directors themselves, the demand requirement has been relaxed by most courts since it would clearly be futile to request the directors to bring suit against themselves. Meltzer v. Atlantic Research Corp., 330 F.2d 946 (4th Cir.), *aff'd sub nom.* Sloan v. Meltzer, 379 U.S. 841 (1964); *In re* Western Tool & Mfg. Co., 142 F.2d 404 (6th Cir. 1944), *rev'd on other grounds sub nom.* Price v. Gurney, 324 U.S. 100 (1945); Somberg v. Bluemschine, 8 F.R.D. 197 (S.D.N.Y. 1948); Maxwell v. Enterprise Wall Paper Mfg. Co., *supra*. For a discussion of the requirement of demand on stockholders, see Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73 HARV. L. REV. 746, 748 (1960); 47 CORNELL L.Q. 84 (1961).

[37] In practical terms, the reason for the rule may lie in the possibility that demand by the stockholder prior to bringing suit may obviate the need for a derivative suit altogether. The directors or majority stockholders may be persuaded to bring suit themselves, thus placing the conduct of the litigation in the hands of those who have a primary responsibility for the management of the corporation's affairs. It is also possible that some other action might be taken which would eliminate the need for a derivative suit, such as removal of the board by the stockholders. Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73 HARV. L. REV. 746, 748-52, 753-62 (1960).

must be fulfilled before the court will proceed to a determination of the merits of plaintiff's claim.[38] But in order for the court to be sure that the plaintiff has complied with these requirements, some assurance is needed that the allegations setting forth such compliance are pleaded truthfully. Positive verification of the special allegations required by rule 23(b) thus serves to insure, at the time suit is filed, that the plaintiff is a proper party, and that he has a right to seek the relief which he demands.

With regard to the allegations required by rule 23(b), then, there is a special need for truthful pleading which is not satisfied by rule 11's requirement that all pleadings be made in good faith. A rational construction of the rule thus might limit the application of the verification requirement to those allegations.[39] Such a construction avoids the difficulties raised by the interpretation placed on the rule in *Surowitz*, in that it neither necessitates the unreasonable imposition of a "comprehension"

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[38] Of course it is true that "there is no such anomaly in modern procedural law as would require plaintiff to plead, as a mere matter of procedure, an allegation of this character without the necessity of proving it when controverted." 3 MOORE, FEDERAL PRACTICE ¶ 23.15(2), at 3499 (2d ed. 1964); see Rinn v. Asbestos Mfg. Co., 101 F.2d 344 (7th Cir. 1938), *cert. denied*, 308 U.S. 555 (1939) (allegation as to time of ownership must be pleaded *and* proved). But even though the plaintiff's right to be a party to the litigation may be challenged at a later stage, the allegations as to standing are primarily relevant at the time suit is filed. See notes 35-36 *supra*.

The prior demand requirement is, of course, related to issues to be litigated at trial. It has been said that the plaintiff in a derivative suit has, in effect, two claims —he must show 1) that there is some right or claim belonging to the corporation, and 2) that the directors have wrongfully neglected or refused to enforce this right or claim. BALLANTINE, CORPORATIONS § 145, at 343-44 (rev. ed. 1946); Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73 HARV. L. REV. 746, 748, 759 (1960). Since it is the directors who are primarily entrusted with the management of the corporation, their judgment as to whether to enforce the claim or right will be overturned by the court only under extraordinary circumstances, and the plaintiff does not prevail merely by showing that they have failed to sue, or even that they exercised poor judgment in not doing so. BALLANTINE, CORPORATIONS § 147 (rev. ed. 1946). The prior demand provision, however, is a procedural requirement over and above the substantive principle that the directors' exercise of good faith business judgment will not be overturned at the instance of a minority stockholder—the courts will not even permit the stockholder an opportunity to show that the directors' failure to sue was wrongful until he has established that he made reasonable efforts to induce them to do so. Hawes v. Oakland, 104 U.S. 450, 460-61 (1881).

[39] The language of the rule, admittedly, does not compel such a result: "[T]he complaint shall be verified by oath and shall aver . . . ." However, it is interesting to note that in older usage, the word "aver" was virtually synonymous with "verify." BLACK, LAW DICTIONARY 171 (4th ed. 1951); see New York Bond & Mortgage Co. v. McWilliams, 253 Ill. App. 404 (1929) ("averment" of a fact held sufficient to satisfy statute requiring an affidavit of merit). This tends to support a construction of the rule which would limit the application of the verification requirement to the denial of collusion and time of ownership allegations. Note, though, that this reasoning would not apply to the prior demand allegation, since the requirement as to it is only that the facts be "set forth with particularity." Nonetheless it seems that the word "aver," as commonly used, is synonymous with "allege," BLACK, LAW DICTIONARY 171 (4th ed. 1951), and may have been in equity the equivalent of that term. See Mylin v. King, 139 Ala. 319, 35 So. 998 (1904). The 1964 proposed amendments to the federal rules replace the word "aver" with "allege." COMMITTEE ON RULES OF PRACTICE AND PROCEDURE, JUDICIAL CONFERENCE OF THE UNITED STATES, PRELIMINARY DRAFT OF PROPOSED AMENDMENTS TO RULES OF CIVIL PROCEDURE 115 (1964).

requirement on stockholder plaintiffs,[40] nor assigns to the verification requirement a purpose which merely duplicates rule 11's certification provision.

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[40] The problem might still exist, however, if the rule were interpreted to require verification by the plaintiff, rather than his attorney; for it is conceivable that a given plaintiff might not be aware of efforts made in his behalf to secure action from the directors, or might not be able to understand what is meant by the "collusion" to which the rule refers. However, if plaintiffs are properly informed by their attorneys, and if their understanding is tested in terms that laymen would understand rather than in terms of the "technical" language of the rule or of the given allegation, the problem should arise only rarely, if at all. At any rate, there is no particular reason to prohibit verification by the attorney, since the reason for requiring verification at all is merely to obtain an assurance of truthfulness regarding the allegations as to standing—and the attorney may in many cases be better qualified to do this than the plaintiff. See notes 9, 11-12 *supra*.