



Fall 9-1-1962

Prorata Recovery by Shareholders on Corporate'Causes of Action as a Means of Achieving Corporate Justice

Edward J. Grenier, Jr.

Follow this and additional works at: <https://scholarlycommons.law.wlu.edu/wlulr>



Part of the [Business Organizations Law Commons](#), and the [Commercial Law Commons](#)

Recommended Citation

Edward J. Grenier, Jr., *Prorata Recovery by Shareholders on Corporate'Causes of Action as a Means of Achieving Corporate Justice*, 19 Wash. & Lee L. Rev. 165 (1962).

Available at: <https://scholarlycommons.law.wlu.edu/wlulr/vol19/iss2/3>

This Article is brought to you for free and open access by the Washington and Lee Law Review at Washington and Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Washington and Lee Law Review by an authorized editor of Washington and Lee University School of Law Scholarly Commons. For more information, please contact christensena@wlu.edu.

PRORATA RECOVERY BY SHAREHOLDERS ON CORPORATE CAUSES OF ACTION AS A MEANS OF ACHIEVING CORPORATE JUSTICE

By EDWARD J. GRENIER, JR.*†

Ordinarily the entire recovery in a shareholder derivative suit goes to the corporation. On occasion, however, in order to straighten out the affairs of some closely held corporations, courts have decreed direct recovery to shareholders in proportion to the number of shares held by each. In 1955, in the landmark case of *Perlman v. Feldmann*,¹ direct prorata recovery was decreed for the first time in a case involving a publicly held corporation. This significant extension of the prorata remedy opens the way to its use as a practical alternative to a corporate recovery in a great variety of derivative suits. It also, however, is likely to raise a host of problems not previously faced by the courts in dealing with closely held corporations. This article will examine some of the problems and implications, largely unexplored in *Perlman*, arising out of the extension of this remedy to publicly held corporations. Chief among the problems seems to be working out procedural rules which will assure reasonable protection to the potentially conflicting interests of the several groups that make up the large modern corporation. Some of the major implications arising from the *Perlman* decision might relate to the very nature of the corporation and the derivative suit.

I. DEVELOPMENT OF PRORATA RECOVERY

Originally, in the United States the shareholder's suit, although on behalf of his corporation, was not based upon a strict concept of the corporate entity.² The plaintiff brought the action as representative of all the shareholders, except any that might be defendants, even

*Associate, Covington & Burling, Washington, D.C.

†The author wishes to express his thanks to Professor David R. Herwitz of the Harvard Law School, who first led him to a consideration of this subject.

¹219 F.2d 173 (2d Cir.), cert. denied, 349 U.S. 952 (1955), 68 Harv. L. Rev. 1274, on remand, 154 F. Supp. 436 (D. Conn. 1957), 71 Harv. L. Rev. 1559 (1958), 160 F. Supp. 310 (D. Conn. 1958) (final order). This case is extensively discussed in Hill, *The Sale of Controlling Shares*, 70 Harv. L. Rev. 986 (1957).

²See Prunty, *The Shareholders' Derivative Suit: Notes on Its Derivation*, 32 N.Y.U.L. Rev. 980, 989 (1957).

though the recovery inured to the corporation. When such actions were brought against parties outside the corporation, courts began stressing the fact that the cause of action belonged to the corporation as a separate entity, and that the plaintiff was suing primarily as representative of this entity.³ In this way the derivative suit came to be rationalized on a theory of strict separation of the corporation from its shareholders.⁴ However, in order to prevent abuse, the equity courts imposed certain requirements as to standing that had to be met to entitle a shareholder to bring suit.⁵ Even with these procedural safeguards designed to prevent abuses, in certain situations a corporate recovery led to either inconvenience or injustice. Therefore, some courts abandoning rigid formalism, granted recovery directly to the plaintiff-shareholders and other shareholders found entitled to damages in proportion to the number of shares held by each.

A. Distinguished From Individual or Class Actions.

A prorata recovery of damages on a corporate cause of action must be distinguished from recoveries on causes of action owned by shareholders in their own right, and enforceable in either individual or class suits.⁶ A suit by or on behalf of one of several classes of shareholders is not based on a corporate cause of action, and therefore a recovery therein is not "prorata" as the term is used herein.⁷ It may be difficult, on occasion, though to distinguish between the two types of suits. Over a strong dissent, one court has held that a suit to compel declaration of a dividend is derivative in nature.⁸ On the other hand, a shareholder has been permitted to bring an individual suit, in his own name, against insiders for misappropriation of corporate

³Id. at 990-92.

⁴See 4 Pomeroy, Equity Jurisprudence §§ 1089, 1091, 1095 (5th ed. 1941).

⁵For example, the contemporaneous-ownership rule. Fed. R. Civ. P. 23(b)(1), *Hawes v. Oakland*, 104 U.S. 450 (1882).

⁶See, e.g., Stevens, *Private Corporations* § 167, at 784, 796 (2d ed. 1949). But see Comment, 46 Ill. L. Rev. 937 (1952) (advocates nonderivative shareholders' action for diminution in the value of their shares, reserving to the corporation an action for the loss of assets). This recommendation, however, seems to ignore the possibility of the shareholders benefiting twice. Compare *General Rubber Co. v. Benedict*, 215 N.Y. 18, 109 N.E. 96 (1915).

⁷See, e.g., *Zahn v. Transamerica Corp.*, 162 F.2d 36 (3d Cir. 1947). When used alone, "pro rata" hereinafter means prorata recovery.

⁸*Gordon v. Elliman*, 306 N.Y. 456, 119 N.E. 331 (1954) (4-3 decision); cf. *Shanik v. Empire Power Corp.*, 58 N.Y.S.2d 176 (Sup. Ct. 1945), *aff'd mem.*, 270 App. Div. 925, 62 N.Y.S.2d 760, *aff'd mem.*, 296 N.Y. 664, 69 N.E.2d 818 (1946) (derivative suit with prorata recovery).

assets—the classical derivative-suit situation.⁹ Even if prorata recovery would be appropriate in this latter situation, the nature of the suit may be crucial if the plaintiff is unable to meet the procedural prerequisites for bringing a derivative suit.¹⁰ Generally, however, courts have maintained the distinction between recovery by the shareholder in his own right and recovery in a derivative suit of his prorata share of damages payable to the corporation.¹¹

B. Typical Situations in Which Prorata Recovery Has Been Decreed.

Prorata recovery on a corporate cause of action has been decreed: (1) to provide a convenient method for ultimate distribution when the corporation is in liquidation or when its assets have been sold; (2) to protect shareholders from dissipation of a corporate recovery because of foreseeable future mismanagement by the defendants, who will remain in control of corporate affairs; (3) to limit recovery to “innocent” shareholders; and (4) to provide a remedy against those who sell corporate control for an excessive consideration.¹²

The liquidation situation presents no difficulties of theory or policy. In the other situations, however, the corporation is a going concern, and prorata recovery in substance effects a distribution of some corporate assets to certain shareholders.¹³

⁹*Equitable Trust Co. v. Columbia Nat'l Bank*, 145 S.C. 91, 142 S.E. 811 (1928) (action at law based on conversion of plaintiff's shares through taking of corporate assets). The court appeared influenced in reaching its decision by the fact that all parties below regarded the suit as properly an action at law; thus the defendants should not now be permitted to change position. *Id.* at 133, 142 S.E. at 824.

¹⁰E.g., Fed. R. Civ. P. 23(b)(1); N.Y. Gen. Corp. Law § 61-b (security-for-expenses provision applicable to derivative suits).

¹¹See *Dill v. Johnson*, 72 Okla. 149, 179 Pac. 608 (1919); Note, 40 Calif. L. Rev. 127, 131 n.40 (1952). But see *Tierney v. United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S.E. 249 (1920) (some blurring of this distinction).

¹²See Stevens, *Private Corporations* § 167, at 793-96 (2d ed. 1949); *Developments in the Law—Multiparty Litigation in the Federal Courts*, 71 Harv. L. Rev. 874, 946 (1958) (hereinafter cited *Developments—Multiparty Litigation*); Note, 69 Harv. L. Rev. 1314 (1956); Note, 2 U. Chi. L. Rev. 317 (1935); 23 Minn. L. Rev. 973, 974 (1939). For the remainder of this article, these situations will be called, respectively the liquidation situation; the foreseeable-mismanagement situation; the innocent-shareholder situation; and the sale-of-control situation. These labels may give more of an appearance of clarity than the cases warrant. There is considerable overlapping, and they are intended to describe typical situations rather than to be rigid categorizations. The term “innocent” herein refers to shareholders who are free not merely from actual participation in the wrongful acts, but also from acquiescence, laches, etc. Unless otherwise indicated, it is assumed, as is usual in derivative suits, that the individual defendants are officers or directors of the corporation.

¹³The corporate cause of action is in a real sense a corporate asset, even though it may not be shown on the balance sheet. This asset will cease to exist

1. *Corporation in liquidation.*

Prorata recovery simply provides a procedural short cut in the process of distribution of the corporate assets and is granted by the courts on the ground of convenience, provided corporate liabilities have been discharged.¹⁴

2. *Foreseeable mismanagement.*

When future gross mismanagement on the part of the defendants can be readily predicted on the basis of past performance,¹⁵ prorata recovery should be readily available, provided it is clear that the plaintiffs will not be adequately protected by a corporate recovery. Otherwise, a future derivative suit may be required because of an unlawful dissipation of of this corporate recovery. Perhaps the only exception to the granting of pro rata in such cases should be when the recoverable funds are needed by the corporation to meet current liabilities. It is arguable, of course, that if the record of past mismanagement is so glaring as to require prorata recovery on that basis alone, the long-term interests of the corporation may be better served by granting a corporate recovery and appointing a receiver.¹⁶ Where a closely held corporation is involved a court-decreed dissolution would perhaps be the best solution.¹⁷

3. *Limitation of recovery to "innocent" shareholders.*

Situations in which prorata recovery is decreed in order to limit recovery to "innocent" shareholders¹⁸ present more difficult ques-

after the suit in which prorata recovery is decreed, and the corporation will not receive any of the proceeds as a substitute for this asset. Furthermore, the balance sheet may show assets which have been misappropriated and are the subject of the action, thus emphasizing the fact that the cause of action is a corporate asset, a substitute for the misappropriated assets. Therefore, it is realistic to consider prorata recovery as an effective distribution of a corporate asset.

¹⁴See, e.g., *Sale v. Ambler*, 335 Pa. 165, 6 A.2d 519 (1939); *Alexander v. Quality Leather Goods Corp.*, 150 Misc. 577, 269 N.Y. Supp. 499 (Sup. Ct. 1934).

¹⁵See, e.g., *Backus v. Finkelstein*, 23 F.2d 357 (D. Minn. 1927); *Fougeray v. Cord*, 50 N.J. Eq. 185, 24 Atl. 499 (Ch. 1892), rev'd in part sub nom. *Laurel Springs Land Co. v. Fougeray*, 50 N.J. Eq. 756, 26 Atl. 886 (Ct. Err. & App.) (lower court's decree eliminated plaintiff as a shareholder in the corporation; upper court gave him right to a reasonable dividend); cf. *Eaton v. Robinson*, 19 R.I. 146, 31 Atl. 1058 (1895) (per curiam) (serious prior mismanagement; prorata recovery granted in order to obviate necessity of second suit to compel declaration of a dividend).

¹⁶See Note, 69 Harv. L. Rev. 1314, 1315 (1956). See generally Baker & Cary, *Cases and Materials on Corporations* 706-07 (3d ed. 1958).

¹⁷See Note, 71 Harv. L. Rev. 1498, 1511-14 (1958).

¹⁸E.g., *Young v. Columbia Oil Co.*, 110 W. Va. 364, 158 S.E. 678 (1931) (ratifiers and shareholders with notice of the operations for the directors' benefit barred);

tions of policy. Unlike the liquidation and foreseeable-mismanagement situations, in which the only basic issue is whether or not a corporate recovery should be decreed,¹⁹ there is the additional complication that the wrongdoers may be permitted to retain funds proportionate to the shares held by persons who, although innocent of actual wrongdoing, either tacitly acquiesced in or expressly approved the acts of the defendants. Perhaps when the defendants are directors guilty of flagrant and wilful breaches of fiduciary duty toward the corporation, full payment of the corporate damages should be exacted.²⁰ Even though such recovery may include a punitive element,

Brown v. DeYoung, 167 Ill. 549, 47 N.E. 863 (1897) (per curiam on opinion below) (participator in wrong and acquiescer barred); *Harris v. Rogers*, 190 App. Div. 208, 179 N.Y. Supp. 799 (1919) (shareholders who gave releases barred; some of plaintiff's shares "tainted" and thus barred, but affirmation based upon plaintiff's execution of judgment). The Illinois court later expressly declined to follow the rule of the *Brown* case and granted corporate recovery. *Voorhees v. Mason*, 245 Ill. 256, 91 N.E. 1056 (1910). In *Harris v. Pearsall*, 116 Misc. 366, 190 N.Y. Supp. 61 (Sup. Ct. 1921), appeal dismissed on stipulation, 202 App. Div. 785, 194 N.Y. Supp. 942 (1922), the same plaintiff as in the *Rogers* case was permitted to bring a later derivative suit against the then present directors, successors to those involved in the first suit, for failing to sue the former directors.

¹⁹This is not meant to indicate that the problems arising in the innocent-shareholder situation could not also arise in the two situations discussed above, if some shareholders were found to have acquiesced in the wrongful acts. However, the above situations inherently and necessarily raise only the problem of corporate versus prorata recovery, whereas the innocent-shareholder situation necessarily raises the issues discussed in the text. Solely for the purpose of analysis, each of the situations is assumed to exist in its purest form. Thus, in the foreseeable-mismanagement situation, the only shareholders who would be eliminated from sharing in the recovery are the individual defendants themselves. Of course, these hypothetical situations will rarely be found in pure form in actual cases.

²⁰Cf. *Leech*, *Transactions in Corporate Control*, 104 U. Pa. L. Rev. 725, 823-26 (1956) who, speaking of sale-of-control cases, suggests a derivative suit with full corporate recovery is preferable since recovery is "prophylactic." However, the contention that corporate recovery should be granted because pro rata acts as a pro tanto ratification of nonratifiable fraud, *Keenan v. Eshleman*, 23 Del. Ch. 234, 252, 2 A.2d 904, 912 (Sup. Ct. 1938), 23 Minn. L. Rev. 937 (1939), Annot., 120 A.L.R. 238 (1939), seems highly formalistic. The acquiescing shareholders are not accepting the fraud in the name of the corporation, but are merely forfeiting their right to participate in any recovery.

In these cases, it seems that the breach of fiduciary duty involved is not enough to show continual past gross mismanagement so as to give a basis for predicting future mismanagement. Compare *McCourt v. Singers-Bigger*, 145 Fed. 103 (8th Cir. 1906) (corporate recovery; no prolonged history of serious and constant mismanagement). If, however, the breach is flagrant and willful and the defendants' past conduct over a significant period justifies prorata recovery on the ground of foreseeable mismanagement, perhaps the defendants should be required to pay all shareholders other than themselves, including acquiescers or would-be ratifiers, thus approximating a corporate recovery.

it could be justified as providing a deterrent against such breaches of fiduciary duty.

In less serious situations only prorata recovery may be justifiable even though the defendants violated a fiduciary duty. When the liability of directors arises from negligence, from serious and extensive misjudgments, or from authorization of now completed ultra vires acts, it may be argued that they should not be required to account to acquiescing shareholders. In these latter situations it is more likely that the corporate funds paid out are in the hands of third parties so that damages payable by the directors would not come from such funds. Indeed, the directors may have derived no economic benefit at all from the transactions.²¹ Even in some situations in which the directors obtained corporate funds through a flagrant breach of fiduciary duty, prorata recovery may be appropriate, because the shareholders' acquiescence, under the circumstances, is equivalent to a compromise agreement with the defendants.²² In such instances, the strong policy of the law in favor of settlements without litigation seems to swing the balance in favor of the defendants. Furthermore, the acquiescers merely receive the results of their bargain when recovery is denied to them.

4. *Sale of control in violation of a fiduciary duty.*

The use of prorata recovery as a means of providing a remedy against those who sell corporate control for an excessive consideration presents difficulties similar to those of the innocent-shareholder situation. The primary emphasis in the cases is on holding the purchasers of control to their contract with the defendant sellers and thus denying any recovery to them.²³ Of course, in addition, there may be other shareholders against whom the seller-defendants have personal defences, as in the innocent-shareholder situation. Here, however, a noncontrolling shareholder should not be found to have acquiesced in the sale of control unless he had full knowledge of the material

²¹Cf. *Harris v. Pearsall*, 116 Misc. 366, 190 N.Y. Supp. 61 (Sup. Ct. 1921), appeal dismissed on stipulation, 202 App. Div. 785, 194 N.Y. Supp. 942 (1922). This factor should not be sufficient to cause a prorata, rather than a corporate, recovery; however, it should be considered when the defendants' conduct is not outrageous, even though it involves some sort of breach of fiduciary duty.

²²See *Chounis v. Laing*, 125 W. Va. 275, 23 S.E. 628 (1942) (however, no finding of intent to defraud).

²³See *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.), cert. denied, 349 U. S. 952 (1955). But see *Leech*, *supra* note 20, at 823-26.

facts. Mere failure to object within a reasonable time after the sale should not be considered acquiescence, since sellers of control frequently attempt to conceal such transactions from the noncontrolling shareholders.²⁴ Shareholders with full knowledge, who have failed to act for a long period, should be barred from recovery, for their acquiescence must certainly be conscious. In some cases, it may even be in the nature of a contractual compromise of liability.

Of course, the use of prorata recovery presupposes that a corporate cause of action exists. Such a cause exists if some corporate "opportunity" or "asset" has been appropriated by the defendants for their own benefit.²⁵ However, in many cases the only real injury seems to be to the noncontrolling shareholders, who either were not permitted to participate in the sale or were induced to sell at a price lower than that received by the controlling shareholders. In logic, it seems that in such situations an individual or representative action by such noncontrolling shareholders in their own right should be permitted.²⁶ Such an action avoids the conceptual difficulty of permitting persons no longer shareholders to receive a portion of damages due to the corporation.²⁷ The ultimate result of such an individual action should be the same as that of a derivative suit with prorata recovery, for in either case an accounting for any excess "premium" will be required since liability is based upon a breach of fiduciary duty.²⁸

²⁴See, e.g., *Commonwealth Title Ins. & Trust Co. v. Seltzer*, 227 Pa. 410, 76 Atl. 77 (1910).

²⁵See, e.g., *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.) cert. denied, 349 U.S. 952 (1955).

²⁶See, e.g., *Sautter v. Fulmer*, 258 N.Y. 107, 179 N.E. 310 (1932). But see *American Trust Co. v. California W States Life Ins. Co.*, 15 Cal. 2d 42, 66, 98 P.2d 497 (1940) (injury to the corporation). If injury both to the corporation and to former shareholders is shown, probably both a derivative suit and an individual action by the former shareholders should be permitted. But care should be taken not to decree the equivalent of a double recovery against the defendants (compare note 6, *supra*), except possibly in the very limited situation described in note 71, *infra*, if it is found that the wrong to the corporation injured both a former and present shareholder.

²⁷But cf. *Watson v. Button*, 235 F.2d 235 (9th Cir. 1956), 35 N.C.L. Rev. 279 (1957) (in nonderivative suit former shareholder in two-man corporation allowed to recover prorata share of corporate damages).

²⁸Compare *Perlman v. Feldmann*, 154 F. Supp. 436 (D. Conn. 1957) (prorata recovery), with *Sautter v. Fulmer*, 258 N.Y. 107, 179 N.E. 310 (1932) (nonderivative suit). However, the measure of damages might be different if the action is based upon deceit. See *Baker & Cary*, *op. cit. supra* note 16, at 596. Furthermore, it is assumed in the text that no damages against the sellers for actual looting by the purchasers, see *Insuranshares v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940), will be recoverable.

C. Possible Use of Prorata Recovery to Bar "Subsequent" Shareholders From Sharing in Damages Recoverable by the Corporation.

Although in many jurisdictions a shareholder does not have standing to bring a derivative suit unless he was a shareholder at the time of the wrong,²⁹ no court has decreed prorata recovery solely because some of the shareholders at the time of suit were subsequent shareholders. The purpose of the rule on standing to sue is to prevent speculation in litigation and to reduce the likelihood of strike suits;³⁰ it is not based on a feeling that it is unfair to permit subsequent shareholders to benefit from a recovery.

It has been held, however, in the leading case of *Home Fire Ins. Co. v. Barber* and in two other cases,³¹ that the corporation itself is barred from recovery when all the present shareholders are subsequent shareholders. In that situation, then, it is not possible, in jurisdictions adhering to the *Home Fire Ins. Co.* rule, to bring a derivative suit either because subsequent shareholders have no standing to sue or because the plaintiff in a derivative suit cannot assert greater rights than those of his corporation.³² On the other hand, the presence of just one contemporaneous shareholder, perhaps the holder of only one share in a large publicly-held corporation, can lead to the dramatically opposite result of a full corporate recovery. In such an extreme situation, it seems more

²⁹E.g., Fed. R. Civ. P. 23(b)(1); N.Y. Gen. Corp. Law § 61. A shareholder who would qualify under these statutes will be referred to as a contemporaneous shareholder. One who would not qualify will be called a subsequent shareholder.

³⁰See Developments—Multiparty Litigation, 71 Harv. L. Rev. 874, 951-52, 967 (1958).

³¹*Park Terrace, Inc. v. Burge*, 249 N.C. 308, 106 S.E.2d 478 (1959), 37 N.C.L. Rev. 320 (1959); *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903); *Capitol Wine & Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291 (1950), aff'd per curiam, 302 N.Y. 734, 98 N.E.2d 704 (1951). In the *Home Fire Ins. Co.* case the court specifically noted that the present shareholders had paid a fair consideration for their stock and were thus not injured by the prior mismanagement. *Home Fire Ins. Co. v. Barber*, supra at 657, 663, 93 N.W. at 1029, 1031. The court in *Pokrass* relied upon the lack of standing in the jurisdiction of a subsequent shareholder to bring a suit on behalf of the corporation. The fairness argument of the *Home Fire Ins. Co.* case was relied upon in the concurring opinion. *Capitol Wine & Spirit Corp. v. Pokrass*, supra at 189-90, 98 N.Y.S.2d at 296-97.

³²See Glenn, *The Stockholder's Suit—Corporate and Individual Grievances*, 33 Yale L.J. 580, 588 (1924). But see *Di Tomasso v. Loverro*, 250 App. Div. 206, 293 N.Y. Supp. 912, aff'd per curiam, 276 N.Y. 551, 12 N.E.2d 570 (1937) (corporation barred because in pari delicto as party to contract in restraint of competition, but shareholder allowed to recover from directors prorata share of corporate damages on the contract). The *Di Tomasso* rule would not apply, however, when the bar against the corporation arises only because of the unfairness of allowing the shareholders to benefit from a recovery.

logical and reasonable to decree prorata recovery, and so allow recovery only to the single contemporaneous shareholder.³³

Certain factors, however, may point toward the desirability of a corporate recovery, even when *all* the present shareholders are subsequent shareholders. If the loss of corporate assets remains concealed until shortly before the suit, the substantial injury really falls upon the present shareholders, whether contemporaneous or subsequent. It is likely that former shareholders sold out at prices higher than those obtainable if the wrong had been known. If the suit is against directors or officers, there is no policy reason for releasing them from liability if their wrong has caused a present injury to present shareholders. If the suit is against persons never within the corporation (for example, persons who allegedly violated a contract with the corporation), the failure of a prior management to bring suit should not bar an action regardless of when the breach was discovered and the status of present shareholders. The rule of *Home Fire Ins. Co. v. Barber*³⁴ seems inapplicable, since outsiders should be bound by their undertaking and not be permitted to look behind the corporate entity.

The *Home Fire Ins. Co.* rule and its extension, through the use of prorata recovery,³⁵ to the situation where substantially all the shareholders are subsequent may not be fully operative unless there is but a single class of common shareholders. It is arguable that bondholders³⁶ and preferred shareholders, whether "contemporaneous" or

³³See *May v. Midwest Ref. Co.*, 121 F.2d 431 (1st Cir.) cert. denied, 314 U.S. 668 (1941).

³⁴67 Neb. 644, 93 N.W. 1024 (1903). This case involved breaches of fiduciary duty by directors and officers of a closely-held corporation. The court itself noted that, since the "corporation is not asserting or endeavoring to protect a title to property, it can only maintain a suit in equity as the representative of its stockholders..." Id. at 664, 93 N.W. at 1031-32.

³⁵The same prorata recovery can be obtained even if the corporation itself brings the suit under a new management. See *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 Atl. 645 (1917).

³⁶The ordinary trade creditor should not be afforded any special rights so long as he still may enforce his primary cause of action against the corporation. Upon insolvency in the equity sense, it seems that such a creditor should be able to prevent any direct prorata recovery by the shareholders. See text after note 55 and at notes 56-57, *infra*; *Stevens, Private Corporations* §§ 167, 168, at 797, 799 (2d ed. 1949). Similarly, the rule of the *Home Fire Ins. Co.* case itself should be inapplicable, since in the insolvency situation a corporate recovery is really for the benefit of creditors, and not the subsequent shareholders. But see *Capitol Wine & Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291 (1950), *aff'd per curiam*, 302 N.Y. 734, 98 N.E.2d 704 (1951) (amended complaint alleging that suit is solely for benefit of creditors—government's for unpaid taxes—not permitted; but no indication of insolvency). It seems that a creditor's knowledge of the wrong when he extended the credit should be immaterial. Cf. *Easton Nat'l Bank v. American Brick & Tile Co.*, 70 N.J. Eq. 732, 64 Atl. 917 (Ct. Err. & App. 1906).

"subsequent," as those terms are used in this article, are always entitled to a corporate recovery, at least to the extent necessary to restore impaired capital.³⁷ They might even be entitled to a corporate recovery over and above this amount so as to provide sufficient working capital to prevent another impairment of capital as a result of current operations.

Bondholders especially have strong ground for demanding a corporate recovery. They are senior to all other interests, and they cannot enforce their rights until their bonds are mature. Bondholders as a group should have the continuing right to some corporate recovery when capital has been impaired even if all the bonds changed hands between the occurrence of the wrong and the time of suit. This argument possesses less force when extended to preferred shareholders, even if they have a liquidation preference, for they are corporate risk-takers and entitled to maintain derivative suits to redress corporate wrongs.³⁸ Nevertheless, they do seem entitled to a "cushion" argument similar to that of the bondholders.

Even when the capital of the corporation consists entirely of a single class of common stock and the suit is against corporate insiders, prorata recovery may be inappropriate if only a comparatively small number of the shareholders are subsequent. Logically, the same rules governing the availability of prorata recovery should apply whether a shareholder brings a derivative suit or new management brings a corporate suit.³⁹ A rigid rule requiring prorata recovery in such situations would result in the diversion of a considerable amount of assets away from the corporate treasuries. Such a rule would work exceptionally great mischief in publicly held corporations with actively traded stock; in such corporations some shareholders are almost always bound to be "subsequent." Furthermore, the great majority of the shareholders, especially in publicly held corporations, would probably prefer to have such assets remain in the corporation in order to produce long-term growth and profitability. Of course, the amounts received in such a prorata distribution could be re-invested, but this may not be practicable if each shareholder receives

³⁷Cf. *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 Atl. 645 (1917). The court mentioned specifically that there was no showing that the corporation needed the recovery in order to pay creditors, that the capital was impaired, or that there would be any injury to the preferred shareholders if pro rata were decreed.

³⁸See *Ashwander v. Tennessee Valley Authority*, 297 U.S. 288, 321 (1936) (voting preferred); cf. *Shanik v. Empire Power Corp.*, 58 N.Y.S.2d 176 (Sup. Ct. 1945), aff'd mem., 270 App. Div. 925, 62 N.Y.S.2d 760, aff'd mem., 296 N.Y. 664, 69 N.E.2d 818 (1946) (nonvoting participating stock).

³⁹See note 35 *supra*.

but a small amount, and it may be inconvenient if a charter amendment is required for the issuance of any new shares necessary for such reinvestment.⁴⁰

If the *Home Fire Ins. Co.* rule is extended in the breach-of-fiduciary-duty case to the situation in which substantially all the shareholders are subsequent, and rejected when substantially all the shareholders are contemporaneous, there will remain difficult problems of application in intermediate situations when the factors mentioned above as strongly pointing toward a corporate recovery are lacking. It is arguable that if no creditors or senior security-holders are prejudiced, prorata recovery should be decreed whenever it is clear that the wrongful acts 'could have damaged only the contemporaneous shareholders. A showing that the subsequent shareholders purchased at a price depressed because of the wrongs is some evidence of this, although it is difficult to devise a reliable method for isolating the impact of the wrong on the price of the shares. The defendants should have the burden of proving clearly that all the elements justifying prorata recovery, including the clear financial solvency of the corporation, are present. At some point the number of subsequent shareholders would be sufficiently large so that the burden be shifted to those who oppose pro rata to show that the wrong actually injured subsequent shareholders or that the financial condition of the corporation requires a corporate recovery. This type of adjustment in the burden of proof should provide a reasonably workable method for achieving desirable corporate-law results. Subject to all the foregoing conditions, therefore, in some circumstances a decree awarding prorata recovery solely because of the presence of subsequent shareholders in the corporation would be justifiable.

II. RIGHT TO REQUEST, OBJECT TO, AND SHARE IN PRORATA RECOVERY

A. *Standing to Request and Object.*

There is no objection to allowing either party to request prorata recovery in the liquidation situation, since the primary reason for the request is to afford greater convenience,⁴¹ but in the foreseeable-

⁴⁰Furthermore, registration of a new issue of shares with the SEC might be required under the Securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. §§ 77a-77aa (1958), as amended, 15 U.S.C. § 77b (Supp. II, 1961).

⁴¹Compare *Sale v. Ambler*, 335 Pa. 165, 6 A.2d 519 (1939) (requested by the plaintiff), with *Shanik v. Empire Power Corp.*, 58 N.Y.S.2d 176 (Sup. Ct. 1945), aff'd mem., 270 App. Div. 925, 62 N.Y.S.2d 760, aff'd mem., 296 N.Y. 664, 69 N.E.2d 818 (1946) (requested by the defendant).

mismanagement situation only the plaintiffs or intervening plaintiffs should be permitted to make this request. Even though prorata recovery appears to diminish the amount of damages recoverable from the defendants, in most instances the defendants are large shareholders as well as managers and thus derive proportionate benefit from any corporate recovery.⁴² Of course, this need not be the case; especially in a large publicly-held corporation these manager-defendants may own no shares at all, so that the full amount of damages will be recoverable regardless of the type of recovery. In any event, it is unlikely that a court will accept an argument by the defendants in a foreseeable-mismanagement situation that prorata recovery should be decreed because "our past terrible record shows we are likely to mismanage in the future." Furthermore, prorata recovery in this situation is granted because of the possibility of future losses from mismanagement, rather than because of any right in the defendants to limit the recovery on the basis of defenses against some of the plaintiff group.

The decreeing of prorata recovery because recovery should be limited to innocent or contemporaneous shareholders depends entirely upon personal defenses against some shareholders, so that only the defendants should be permitted to request pro rata.⁴³ Furthermore, no policy interest is served by allowing some shareholder-plaintiffs to allege that other shareholders should be barred from recovery.

Similar considerations apply in the sale-of-control situation. If the action is conceived of as a corporate cause of action, only the defendants should be able to request prorata recovery. Of course, some of these suits may be in the nature of individual causes of action possessed by the noncontrolling shareholders.⁴⁴

⁴²See, e.g., *Backus v. Finkelstein*, 23 F.2d 357 (D. Minn. 1927); *Henry G. Davis & Co. v. Gemmell*, 73 Md. 530, 21 Atl. 712 (1891). As noted in footnote 19, *supra*, in the "pure" foreseeable-mismanagement situation, the only shares barred from participation in the recovery are those held by the individual defendants themselves.

⁴³See, e.g., *Joyce v. Congdon*, 114 Wash. 239, 195 Pac. 29 (1921); *Brown v. DeYoung*, 167 Ill. 549, 47 N.E. 863 (1897) (per curiam on opinion of court below). But see Note, 2 U. Chi. L. Rev. 317, 322 n.28 (1935) (interpreting a comment made by one court).

⁴⁴Such suits might be considered "spurious" class suits under Federal Rule 23(a)(3), and thus not binding on absentees, since each shareholder would possess his own separate cause of action. See Moore, *Federal Practice* par. 23.10, at 3442-50 (2d ed. 1948). However, in this type of suit there seem to be no reasons of policy for refusing to permit the common questions arising from the sale to be determined once and for all in the class suit, provided the test of adequacy of representation is met, with each member of the class then permitted to come in and prove his claim. See Chafee, *Some Problems of Equity* 280-88 (1950); *Developments—Multi-party Litigation*, 71 Harv. L. Rev. 874, 936-39 (1958).

Shareholder-plaintiffs should have standing to object to prorata recovery requested by a defendant, whereas it would be incongruous to honor such an objection by a defendant.⁴⁵ Some might argue that the plaintiffs should have no standing to object, since they will benefit as much if the recovery goes directly to them rather than to the corporation. However, even apart from other considerations,⁴⁶ a dollar in the hands of the shareholder is not the same as a dollar in the corporate treasury. The latter possesses a certain dynamism, the possibility of producing more dollars in profits. The plaintiffs may well, therefore, as investors prefer a corporate recovery, especially if the recovery forms a substantial part of corporate assets.⁴⁷ Furthermore, plaintiffs should be permitted to ask for a corporate recovery in order to benefit shareholders not parties, since the representative character of the suit becomes even more apparent once prorata recovery has been requested.

The plaintiffs, though, are not likely to represent adequately the interests of all the absent shareholders. They have no standing to refute the defendants' allegations of personal defenses against some of the absentees, the basis of the defendants' request for pro rata. Moreover, they may be quite content with prorata recovery, possibly because they have no interest in a long-term investment⁴⁸ or because they would recover a sizeable sum of money which would then be available for more profitable investment elsewhere. Consequently the personal interests of the plaintiffs may be antagonistic to the

⁴⁵This incongruity was pointed out in *Perlman v. Feldmann*, 219 F.2d 173, 178 (2d Cir.), cert denied, 349 U.S. 952 (1955). Of course, a defendant may use incongruous arguments, even those pointing to increased liability, in order to ward off the evil day for payment of any damages—hardly a position that would appeal to a court of equity. See *Weeks v. Bareco Oil Co.*, 125 F.2d 84, 90 (7th Cir. 1941).

In the liquidation situation, there is no point in permitting anyone to argue for a corporate recovery, for presumably the court will insure that the rights of creditors are upheld before allowing shareholders to receive any of the fund after a prorata recovery is decreed.

⁴⁶For example some courts have denied recovery of attorney's fees to the plaintiffs because the recovery does not benefit the corporation. See, e.g., *Joyce v. Congdon*, 114 Wash. 239, 195 Pac. 29 (1921). However, these cases did not involve a group of shareholders eligible to share in the recovery large enough to be considered a class. In at least one case, *ibid.*, the recovery for the plaintiff "class" was so small that an attorney's fee could not have been taken out of it; thus any such fee would have required an additional recovery from the defendants. However, if a large enough group of shareholders is involved, the suit should be treated like any other class suit, with the fees being taken from the fund recovered. See *Perlman v. Feldmann*, 160 F. Supp. 310 (D. Conn. 1958); Note, 69 Harv. L. Rev. 1314, 1319 (1956).

⁴⁷See *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 947 (1958).

⁴⁸See *ibid.*

interests of many of the absentees. A fortiori, the plaintiffs may fail to represent adequately the interests of others, such as bondholders, with interests in the corporation.

B. *Notification to Persons or Classes not Before the Court.*

In view of these possibilities, notification should be given to absent shareholders of the pendency of the action and the possibility that prorata recovery will be decreed.⁴⁹ When the plaintiffs do not adequately represent all interests any attempt to bind inadequately represented absentees on the issue of whether prorata recovery should be decreed may violate due process.⁵⁰ Such notification, with an invitation to intervene, should satisfy due process,⁵¹ for it affords an

⁴⁹See Note, 69 Harv. L. Rev. 1314, 1316 (1956). But see *Chounis v. Laing*, 125 Va. 275, 23 S.E. 628 (1942) (notice not necessary because shareholders can intervene after the decree and still recover); *Bailey v. Jacobs*, 325 Pa. 187, 189 Atl. 320 (1937) (court holds failure of shareholders to join in suit is assent to defendants' acts or waiver of rights). Both of these cases overlook the considerations in favor of pre-decree notice.

⁵⁰Cf. *Hansberry v. Lee*, 311 U.S. 32 (1940). Representation may not be adequate unless the claims and defenses of absentees are actually litigated. See Note, 46 Colum. L. Rev. 818, 831 (1946); cf. Note, 67 Harv. L. Rev. 1059, 1065 (1954). It has been stated that the adequacy of representation and the question of whether to permit the suit to be maintained as a class suit is or should be within the trial court's discretion. See *Wheaton, Representative Suits Involving Numerous Litigants*, 19 Cornell L.Q. 399, 433 (1934); Editorial Note, 2 How. L.J. 111, 127 (1956) (by implication); Comment, 25 Texas L. Rev. 64, 70 (1946). But see *Weeks v. Bareco Oil Co.*, 125 F.2d 84, 93 (7th Cir. 1941) (dictum) (if facts are undisputed appellate court can exercise its own judgment). Of course, the trial court's determination is subject to review for abuse of discretion. For suggested tests of whether the representation is adequate, see *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 938 (1958); Note, 6 Stan. L. Rev. 120, 141-42 (1953).

⁵¹See Chafee, op. cit. supra note 44, at 231 (though should not grant binding effect to all class suits on basis of notice alone, id. at 276-77); Keffe, Levy & Donovan, *Lee Defeats Ben Hur*, 33 Cornell L.Q. 327, 345-49 (1948) (notice alone should make class suit binding on absentees); Note, 46 Colum. L. Rev. 818 (1946) (if notification is given, all class suits should have collateral estoppel effects against absentees). But see Note, 7 Okla. L. Rev. 472 (1954) (advocates some notice, but it is not decisive of due process).

In the pro rata situation, notice should be sufficient, since, even if no absentees enter the suit, their rights will receive some sort of rough representation, provided some arguments are made both for and against pro rata. Notification will give the absentees a greater opportunity to enter and have their arguments presented more sharply. Even if the absentees form sub-classes, notice should suffice, for there will probably be only a few arguments available to each group; these can be gotten before the court if only a few out of each group come in. The same reasoning seems applicable to such special groups as bondholders and preferred shareholders, both of whom may present only narrowly confined arguments, as indicated in the text. In any event, on the issue of whether to grant pro rata, the pro rata situation may be differentiated from other types of class suits from the point of view of most of the

adequate opportunity to be heard. Stockholders' lists will facilitate this notification,⁵² although these lists may not be fully adequate to insure notice to all interested parties, for example when prorata recovery may be decreed to former shareholders.⁵³ If this is a possibility, in fairness, such former shareholders should be notified and offered the opportunity to argue for prorata recovery. The best available type of notification should be used, with publication used only when identity or whereabouts are unknown.⁵⁴ Failure to notify a former-shareholder group may not be as serious as failure to notify present shareholders, some of whom might wish to argue for a corporate recovery, since, by hypothesis, the defendants will present arguments for pro rata,⁵⁵ and so former shareholders will receive at least rough representation by the defendants.

Certain groups other than shareholders and former shareholders should receive notification. In the liquidation situation, of course all types of creditors should be notified after the decree, but there is not much point in permitting them to argue for a corporate recovery before the decree; thus, they do not need to receive the notice here under consideration. In the remaining pro rata situations, ordinary trade creditors probably should not be given standing to object to prorata recovery, unless they are unable to realize on the primary obligation of the corporation; insolvency in the equity sense should be sufficient basis for giving standing to these creditors. Of course, it is unlikely that either party to the litigation will present evidence of such insolvency. Even so, no elaborate system to give

absent shareholders: The difference between a direct prorata recovery and a corporate recovery does not seem as crucial as retaining or losing a cause of action, as in the usual class-suit situation. Even shareholders who might be in a group barred by pro rata may be better off than absentees in other class-suit situations, since they will be able to contend individually after the decree that they should be within the claimant group, whereas in other class suits once the class loses no member gets a second chance. Therefore, it seems that notice should suffice to bind absentees to the court's determination to grant pro rata, even if such notice without more would not be sufficient in other class suits.

⁵²See *Perlman v. Feldmann*, 160 F. Supp. 310 (D. Conn. 1958).

⁵³See text at notes 68-72, *infra*.

⁵⁴*Cf. Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950).

⁵⁵In the foreseeable-mismanagement situation, it is true that the plaintiffs would present the argument for prorata recovery, but only the defendants could argue for barring subsequent shareholders from participation in the recovery. If the defendants so argue, the former shareholders would most likely receive notice after the decree to come in and claim, if appropriate. See text at notes 85-86 *infra*. If only the plaintiffs argue for prorata in this situation, the subsequent-shareholder issue would not arise; therefore, as a matter of sound judicial administration, it seems that if former shareholders want to obtain part of the recovery, they should be left to whatever right to intervene that they might have.

notice to such creditors is necessary, since hidden insolvency does not occur frequently, and courts are likely to protect creditors when insolvency is known or suspected.⁵⁶ Perhaps it would be desirable to give a general notice by publication of the suit and the possibility of prorata recovery.⁵⁷ If a creditor does appear before the decree is rendered, he should be permitted to argue for a corporate recovery solely on the ground of insolvency.

Bondholders seem to be in a stronger position to object to prorata recovery, since they have no present right of action against the corporation. They should be permitted to demand elimination of any impairment of capital.⁵⁸ If the jurisdiction permits "nimble dividends" to be paid from the net profits of the current or recent accounting period,⁵⁹ the question may arise whether such a statute destroys the bondholders' standing to object to a prorata recovery.⁶⁰ It might be argued that the statutory term "net profits" should be construed to mean profits arising from the operations of the business; thus a recovery in the suit would not be "net profits." Even if this term is broad enough to encompass recoveries in litigation, however, such

⁵⁶See, e.g., *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 190 Atl. 645 (1917) (court mentions that there was no allegation that the money was needed for creditors); *Alexander v. Quality Leather Goods Corp.*, 150 Misc. 577, 269 N.Y. Supp. 499 (Sup. Ct. 1934) (corporation dissolved; court mentions that creditors have been paid).

⁵⁷Cf. *Johnson v. Waters*, 111 U.S. 640 (1884) (notification to creditors by newspaper after decree in creditors' bill); Berger, "Disregarding the Corporation Entity" for Stockholders' Benefit, 55 Colum. L. Rev. 808, 823 (1955).

⁵⁸See text at notes 36-37, *supra*. Normally there could not be a fresh impairment of capital through prorata recovery, since the asset involved, the cause of action, is not likely to appear on the balance sheet. Moreover, if the corporate assets involved in the suit still appear on the balance sheet even though no longer possessed by the corporation, pro rata still would do no more than to confirm an existing impairment.

⁵⁹E.g., Cal. Corp. Code § 1500(b); Del. Code Ann. tit. 8, § 170(a)(2) (1953). See generally Dodd & Baker, *Cases and Materials on Corporations* 1157-63 (2d ed. 1951).

⁶⁰Such recovery has been characterized as a "forced" payment of a dividend. See *Miller v. Crown Perfumery Co.*, 125 App. Div. 881, 110 N.Y. Supp. 806 (1908); Note, 69 Harv. L. Rev. 1314, 1315-16 (1956). This statement seems to envision prorata recovery as if the funds go first to the corporation, usually contrary to actual fact. However, the contention appears to have much force if the corporate cause of action is shown on the balance sheet, or if the misappropriated assets are still shown thereon. It has force in any event if the term "dividend" is not taken in a technical sense. See note 13 *supra*. Perhaps the dividend statute would not literally apply to pro rata unless the cause of action were shown on the balance sheet, and perhaps not even then because of the absence of corporate action. However, the party requesting pro rata might attempt to argue by analogy from the statute so as to defeat the objections of the bondholders—probably without too great a chance for success in view of the bondholders' contract with the corporation.

a statute may refer only to dividends paid through normal corporate action, and not to distributions, possibly analogous to dividends, ordered by a court. Therefore, it seems that such a statute should not affect the standing of the bondholders to object. As in the case when equity insolvency is present, it is unlikely that either side in the suit will offer evidence of an impairment of capital.⁶¹ Consequently, bondholders should receive some sort of personal notice.⁶²

Similar arguments relating to an impairment of capital are available to preferred shareholders. They have an analogous "cushion" argument, especially when they have a liquidation preference. In addition, their standing to object to prorata recovery for the common shareholders should be absolutely clear when there are arrearages on cumulative preferred dividends. Any such recovery to the common without providing for the payment of such arrearages violates the contract among the shareholders *inter sese*. Even the holder of noncumulative preferred without a liquidation preference should have standing to object to prorata recovery in order to insure that assets will be available in the future to pay his noncumulative dividend and to give him something on liquidation. This last argument is especially cogent if a preferred shareholder is permitted to share in a prorata recovery only to the extent that he is entitled to dividends under his contract with the corporation. Alternatively, provided no senior security is prejudiced, perhaps the preferred shareholders should receive so much of the prorata recovery as will return to them capital proportionate to the amount by which the common is impaired. However, this compounds the evil of a capital impairment and may undermine the notion of a capital measuring rod. Permitting the preferred to argue for a corporate recovery seems preferable. In a sale-of-control case, it might be argued that a holder of nonvoting preferred should have no standing to oppose pro rata since he has no voice in control. This argument has force if used to prevent such a holder from joining in a nonderivative class suit by noncontrolling shareholders, seeking an individual recovery. However, the use of the derivative suit in this situation presupposes the existence of some corporate asset or

⁶¹This is true, unless, of course, impairment of capital is involved in the actual litigation.

⁶²Since a hidden capital impairment seems not likely to occur frequently, perhaps notice by mail should be sent to only a fraction of the bondholders, with the remainder being notified through publication, if that would be less expensive.

In the foreseeable-mismanagement situation, it seems that courts should be very sympathetic to the bondholders' request for a receivership to protect whatever corporate recovery they manage to obtain.

opportunity as the basis of the suit,⁶³ and so a preferred shareholder should have the same standing he has in any other *pro rata* situation, and should receive individual notice.

Even though all these notifications appear desirable, the cost of providing them, even by ordinary mail, may be high, especially in a large publicly-held corporation. The allocation of this cost might well have a practical effect on the type of remedy sought. In the first instance, it would seem that the cost of such notice should be borne by the party requesting *pro rata* recovery, since it is his request that produces the need for the notice.⁶⁴ However, since the purpose of the notice is to give absentees the opportunity of arguing for a corporate recovery, it may be argued that the corporation should bear the expense of notice.⁶⁵ Actually, though, the notice is not given for the benefit of the corporation, but rather for the benefit of absentees who may be interested in a corporate recovery. On the other hand, since the parties to the suit and the persons receiving notice represent virtually the totality of interests in the corporation, perhaps at least some part of the burden should be borne by the corporation.⁶⁶

When the defendants request *pro rata*, perhaps the cost of notice should be divided equally between them and the corporation. The defendants should bear some of the burden because they made the original demand for *pro rata* and stand to benefit from decreased damages; yet, at least some of the expense should fall upon those

⁶³See *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.), cert. denied, 349 U.S. 952 (1955).

⁶⁴Cf. Note, 67 Harv. L. Rev. 1059, 1065 (1954) (in class suits, burden should always be on the plaintiff); Note, 6 Stan. L. Rev. 120, 136 (1953). But cf. Gordon, *The Common Question Class Suit Under the Federal Rules and in Illinois*, 42 Ill. L. Rev. 518, 529 (1947); *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 938 (1958) (might in some circumstances in class suits shift burden to the defendants).

⁶⁵Cf. *id.* at 938 n.462 (corporation bears expense of notice in ordinary derivative suit). Cases which deny to the plaintiffs their attorneys' fees because the recovery does not go to the corporation, e.g., *Joyce v. Congdon*, 114 Wash. 239, 195 Pac. 29 (1921), may not be in point here, since the primary import of the notice is to enable persons not otherwise before the court to present arguments for a corporate recovery.

⁶⁶Even though all interests in the corporation may be affected to some extent because of corporate payment of such expenses, the burden of such costs appears to fall most heavily on the common shareholders, for bond interest and preferred dividends must be satisfied prior to payment of dividends on the common. However, senior interests could be burdened considerably if the corporation is in difficult financial circumstances. In any event, bondholders and preferred shareholders should bear a lesser part of the burden, since they are likely to gain less from a corporate recovery than the junior interests and may oppose *pro rata* recovery on only limited grounds and to a limited extent.

who will benefit from the notice. Even though not exact, this division of the expenses will approximate the desired result and will be easy to administer. When the plaintiffs seek pro rata in the foreseeable-mismanagement situation, the corporation should bear the entire expense. Both sides to the litigation are likely to derive benefit from prorata recovery—albeit for differing reasons. Since the defendants are frequently substantial shareholders, allocating the entire burden to the corporation will be equitable, yet easy to administer.⁶⁷ In the liquidation situation, notice prior to the decree seems unnecessary; but if any is required, the cost should be taken out of the fund before the court, since the decreeing of pro rata is a matter of convenience and is merely a short cut to the ultimate result of a corporate recovery. In any event, in all these situations the court should be empowered to allocate this expense according to the equities in the individual case.

C. Right to Share in a Prorata Recovery

Prima facie, the plaintiffs and all other common shareholders not barred because of personal defenses of the defendants against them should be entitled to share in a prorata recovery. However, at least two questions concerning the common shareholders must be answered: (1) Assuming that prorata recovery is decreed on some ground other than mere presence of subsequent shareholders, should subsequent shareholders be barred from recovery? (2) Even if subsequent shareholders are not barred as a group, should some former shareholders be substituted for some present subsequent shareholders?

⁶⁷In this situation, if the defendants own no shares, they will not benefit from any reduced liability (unless they too can claim prorata recovery on another ground). By charging the corporation with the entire cost, the burden will fall predominantly upon the real beneficiaries of the recovery—the common shareholders represented by the plaintiffs—although indirectly. When the defendants do own shares, they would share in this indirect burden, but they receive the benefit of not being forced to pay some of the damages. This is a real advantage, especially if the financial condition of the corporation is not very strong, even though they would have a proportionate interest in what they restore to the corporation if a corporate recovery were decreed.

When it is the defendants who request pro rata, it does not seem inequitable to charge one half of the expense to them even if they are substantial shareholders in the corporation. The bulk of the burden will thus fall upon the defendants, but they have the most to gain through pro rata. It is true that this arrangement would not place any of the burden upon former shareholders. However, the defendants may benefit from the arguments for pro rata offered by such persons and may need them in order to prove that the impact of the wrongful acts fell solely upon the former holders. This will benefit the defendants if they can thus bar some present shareholders and still cut out some of the former holders through various personal defenses.

Since pro rata is decreed anyway, there is no need to consider the subsequent shareholders as a group, and thus the analysis used to determine whether pro rata should be decreed solely because of the presence of subsequent shareholders⁶⁸ is inappropriate. Any number can be excluded without inconvenience, and therefore each shareholder's case should be examined on its merits.

Because of the wrongful acts, some of the present shareholders may have purchased at a lower price than they would otherwise have paid. If so, it may be argued that a former contemporaneous shareholder, who sold without knowledge of the wrong, should share in the recovery rather than his purchaser.⁶⁹ This can be rationalized on the ground that, if permitted to recover, the subsequent shareholder will be unjustly enriched at the expense of the innocent, unknowing, contemporaneous shareholder. Such a substitution should not depend upon the subsequent shareholder's knowledge of the wrong,⁷⁰ but the case for substitution is even stronger if the subsequent shareholder had knowledge of the wrong while his seller did not. The right to substitution becomes more doubtful if both purchaser and seller had knowledge of the wrong at the time of sale. It is possible that, even though the purchase price was lower than it would have been had there been no wrong, part of the consideration was for the possibility that the corporation might some day recover for the wrong. If so, it seems that the former shareholder should be excluded. Of course, it may be impossible to determine whether any of the consideration was so allocated. The court must then weigh the equities between the parties. If it is found that the former shareholder was fully aware of his personal loss because of the wrong and that he sold because he did not want to risk further loss, it seems more equitable not to allow him to be substituted for the present subsequent

⁶⁸See part I C., *supra*.

⁶⁹*Cf. Watson v. Button*, 235 F.2d 235 (9th Cir. 1956) (factor of lack of knowledge stressed in nonderivative suit by former shareholder to recover his proportionate share of corporate damages).

⁷⁰The result of any given case should not differ solely because the shareholder at the time of the suit is removed by several mesne conveyances from the holder of the shares at the time of the wrong. Unless otherwise indicated, the "subsequent shareholder" referred to in the text is the actual purchaser from the contemporaneous shareholder. Except as indicated, a later subsequent purchaser stands in the shoes of his predecessor. For a discussion of this problem, see *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 948-49 (1958).

Even if pro rata is decreed solely because of the presence of subsequent shareholders, the question of whether the contemporaneous shareholders should be substituted for any or all of the present subsequent holders must be considered on an individual basis. Moreover, it is possible that some of the subsequent shareholders might recover, even though their group as a whole is *prima facie* barred.

shareholder. If the court finds that the former shareholder, although he knew of the wrong, was not fully aware of its effect upon him, perhaps the equities point toward a recovery for him. Similarly, if the seller had full knowledge of the wrong, but the subsequent-shareholder-purchaser had no knowledge, the subsequent shareholder may prevail over him; but less than full knowledge on the part of the seller may lead to the opposite result. In any event, if the defendants can show that recovery by the subsequent shareholder would involve a windfall and that the former shareholder waived his rights or relinquished them to his purchaser, the defendants should not be required to pay either claimant. The defendants should be liable to the present shareholder only to the extent that the wrongful act injured him.

If the subsequent shareholder paid a consideration to the contemporaneous shareholder equal to what would have been paid had there been no wrong, it seems that the subsequent shareholder should recover.⁷¹ A recovery by the former shareholder would unjustly enrich him, whereas denial of all recovery whatsoever would seem to enrich the defendants unjustly; for, by paying a full consideration, the subsequent shareholder has taken upon himself the impact of the defendants' wrong against the corporation. In all these variations of this situation, very difficult problems of valuation are likely to be presented to the court.⁷² Yet, this approach seems more likely to

⁷¹Compare text following note 33 and at note 34, *supra*. If the present shareholder is one removed by several mesne conveyances from the contemporaneous shareholder, an attempt should be made to determine whether he paid a full consideration, as described in the text. If so, this should be determinative rather than the consideration paid by the original subsequent shareholder. Perhaps the most difficult case would arise when the present subsequent shareholder has paid a full consideration, but the former contemporaneous shareholder received a price depressed because of the wrong, the real gain thus going to some intermediate subsequent shareholder. In this case, the court should strive to protect the present shareholder, for example, by placing a greater burden upon the contemporaneous shareholder to show that he did not fully understand the impact of the wrongful acts upon him and did not merely want to avoid further risk of loss. If the equities are perfectly balanced, however, perhaps the defendants should be compelled to recompense both for their loss, since the wrongful acts have in fact injured both. This is likely to occur so infrequently that it does not seem unfair to impose this burden upon the defendants. However, the defendants might be given a defense against the present shareholder, although liable to the contemporaneous holder, if they can prove that the price paid by the present holder depended solely upon independent market factors operating after the wrong was known or could have been known by buyers and sellers.

⁷²Courts, though, have solved difficult valuation problems. See, e.g., *Perlman v. Feldmann*, 154 F. Supp. 436 (D. Conn. 1957).

achieve substantial justice than a blanket rule of excluding or including subsequent shareholders.

Trade creditors of the corporation should have no right to share in any prorata recovery, but if the corporation is insolvent in the equity sense, they should be able to prevent such recovery until they are paid.⁷³ Although bondholders may be able to prevent prorata recovery until an impairment of capital is corrected, it does not seem that they would be entitled to any of the principal on the bonds under the bond indenture until maturity. However, they should be permitted to collect arrearages in interest payments before any payments are made to the shareholders. Preferred shareholders may be in a somewhat different position; they are equity holders and risk-takers. But since they are entitled to receive only limited dividends, whether cumulative or not, they should share in a prorata recovery only to the extent of such dividends, payable at the time of suit but not yet paid, and should not be entitled to any return of capital.⁷⁴

III. PROCEDURE AFTER THE DECREE

If a closely-held corporation is involved in the suit, no substantial mechanical difficulties should arise after prorata recovery is decreed. Normally only a single class of common shares exists, and all the shareholders either are parties or can be easily joined.⁷⁵ In such cases, courts have had no difficulty in making the distribution of damages, usually through a master.⁷⁶ No unfamiliar problems are presented.

As previously noted, *Perlman v. Feldmann*⁷⁷ was the first pro rata case involving a corporation whose shares were widely held. The

⁷³See text at notes 56-57, *supra*. For a fuller discussion of the rights of bondholders, see text at notes 58-62, *supra*.

⁷⁴See text at and around note 63, *supra*. This right would extend to any dividends not paid at the time of decree and arguably might include dividends for the entire current year, even though not yet payable, if it appears that they might not otherwise be paid. In the liquidation situation, these shareholders should receive out of the fund collected only what they are entitled to by contract on liquidation; of course, all senior security interests and trade creditors must first be satisfied out of the fund if they are not otherwise paid.

⁷⁵See, e.g., *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 81 N.W. 1064 (1900).

⁷⁶See, e.g., *Backus v. Finkelstein*, 23 F.2d 357 (D. Minn. 1927). In *Eaton v. Robinson*, 19 R.I. 146, 31 Atl. 1058 (1895) (*per curiam*), the court avoided problems of distribution by awarding judgment only to those shareholders before the court. However, this would force the remaining shareholders to commence future actions, with possible statute-of-limitations difficulty.

⁷⁷219 F.2d 173 (2d Cir.), cert denied, 349 U.S. 952 (1955). This case, apparently, did not present any of the problems arising from the existence of bondholders, preferred shareholders, or ordinary creditors.

final order merely provided for the clerk to send notice to all stockholders appearing on a list submitted to the court, apparently without an examination of the status of those holders.⁷⁸ Thus, the problem of effecting the distribution remained simple.

When the distribution is more complex, it may be possible to include in the notice given prior to the decree⁷⁹ a statement of when to present claims after the decree. However, the exact date of the decree will be very difficult to estimate, especially if many persons appear to contest the granting of prorata recovery. Therefore, a second notice—after the decree—will probably be needed. Since a pro rata case after the decree is not different from an ordinary class suit, the normal class-suit rule placing the burden of giving notice upon the plaintiffs, with the costs being taken from the fund recovered, should be followed.⁸⁰ Unlike notice before the decree, when the primary issue is whether or not to grant pro rata, the corporation as a whole is not involved; this notice after decree is entirely for the benefit of those who might claim a share in the recovery.

The actual machinery for effecting distribution could be the same as that worked out for use in an ordinary class suit:⁸¹ (1) The court enters an interlocutory order or decree for the plaintiffs of record and all similarly situated who come in prior to a specified deadline. (2) A master is appointed, to whom the defendants are compelled to give whatever names and addresses of absentees they have in their possession. This is important if former shareholders are to participate in the recovery, for the defendants may be able to provide records giving their identity. Of course, the defendants will be compelled to turn over the current stockholder lists, if in their possession and if they have not done so for the purpose of prior notification. (3) The plaintiffs' attorney or the master submits the forms for proof of claims with explanatory material to the judge for approval and then mails them to the absentees. (4) The absentees are required to file their claims

⁷⁸160 F. Supp. 310, 311 (D. Conn. 1958). The court did not raise the problem of the existence of subsequent shareholders, although in fact almost all the shares were held by one subsequent shareholder at the time of the decree. Jennings, *Trading in Corporate Control*, 44 Calif. L. Review. 1, 3 n.12 (1956).

⁷⁹See part II B., *supra*.

⁸⁰See *Perlman v. Feldmann*, 160 F. Supp. 310, 312 (D. Conn. 1958); Wheaton, *supra* note 50, at 438-39, 440 (the class-suit rule).

⁸¹See Kalven & Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. Chi. L. Rev. 684, 693-94 (1941). The main outlines of the authors' proposal are presented in the text. The authors regard this procedure as the "maximum complexity" permissible for class suits. *Id.* at 694. See also *Backus v. Finkelstein*, 23 F.2d 357, 366 (D. Minn. 1927).

within a prescribed period. The defendants are permitted to file objections raising personal defenses, but not the common questions settled in the main suit. (5) The master hears objections and determines the individual damages. (6) Upon submission of the master's report, the court hears objections and then renders a final decree ordering the defendants to pay. The court reserves jurisdiction until the end of the distribution.

The use of this machinery presents no great difficulty when the extent of the damages recoverable from the defendants depends entirely upon the number of present shareholders who prove their claims, only the liability per share having been determined during the suit. The defendants should have the burden of proving personal defenses against the claimants, who are merely required to establish their identity as shareholders. In most instances, the defendants should be able to prove acquiescence readily enough through the records of shareholders' meetings; it seems that once such records are introduced, the claimants should have the burden of going forward to show that their apparent acquiescence was not real. The defendants, however, should have the ultimate burden of persuasion since they stand to benefit from a reduced recovery.⁸²

More difficulty will be encountered if former contemporaneous and present subsequent shareholders compete for the recovery. In order to prevent a double recovery (by both the former and present shareholders), it may be necessary for the court to ascertain the total amount of damages that could possibly be recovered from the defendants.⁸³ The court might then merely pay out the fund on a first-come-first-served basis. This haphazard system, however, would hardly carry out the equitable purposes of prorata recovery. It has been suggested that a presumption against recovery by the subsequent shareholders should be established until they show that they are entitled to the recovery in a proceeding of which the former shareholders have notice.⁸⁴ However, since it will usually be predictable that some former shareholders will be entitled to recover,⁸⁵ and this can be indicated in the interlocutory decree, the general post-decree

⁸²But see *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 948 (1958). The result should be the same in the foreseeable-mismanagement situation: All the shareholders other than the defendants would recover directly from the defendants unless they prove personal defense against some.

⁸³Compare *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.), cert. denied, 349 U.S. 952 (1955), on remand, 154 F. Supp. 436 (D. Conn. 1957). However, in one situation a double recovery might be desirable. See note 71 *supra*.

⁸⁴*Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 949 (1958).

⁸⁵This is especially true in the sale-of-control cases.

notification to all possible claimants should suffice. If the identity of some of the former shareholders is unknown, presumably because of sales on stock exchanges, notice by publication could be used; such a notice would identify the period during which the shareholders could be considered "contemporaneous." Of course, every effort should be made to trace a chain of title back from a present shareholder to a contemporaneous holder. If, however, the original post-decree notice by publication presents the only means of finding the contemporaneous holder, that notice should specify the date by which such a holder must come forward.⁸⁶ After that date, the court should determine the equities as between the remaining present subsequent shareholders and the defendants;⁸⁷ if it is determined that these shareholders suffered no injury from the defendants' acts, the defendants' liability would be reduced *pro tanto*.

IV SOME EFFECTS OF GRANTING PRORATA RECOVERY

The preceding discussion has focused upon some of the implications arising from the possibility of a prorata recovery. Now some inquiry must be made into the nature of the suit once pro rata is decreed. Does the suit remain essentially derivative in character, or does it become some type of class action? If the latter, at least in situations in which the plaintiffs can request pro rata initially, should the plaintiffs be excused from complying with the procedural requirements for derivative suits?⁸⁸ The first question may be somewhat misleading, for the ordinary derivative suit is certainly a type of representative suit.⁸⁹ Nevertheless, at least for the purpose of notification to absentees and distribution of the recovery, the suit seems to be treated

⁸⁶See Wheaton, *supra* note 50, at 439. If the contemporaneous holder does come forward, the defendants should be allowed at that time to argue against recovery by either claimant, provided they do not rely on defenses already decided against them in the main suit.

⁸⁷If prorata recovery is decreed solely because of the presence of subsequent shareholders, this question would have been settled during the main suit, unless some, but not all, such shareholders can prove that they were the ones harmed by the wrongful acts. See text at notes 68-72, *supra*.

⁸⁸This may be especially crucial in states which require security for costs from certain plaintiffs in derivative suits. E.g., N.Y. Gen. Corp. Law § 61-b. See Goldstein v. Weisman, 185 F. Supp. 242, 250-51 (S.D.N.Y. 1960) (problem hinted at, but not faced).

⁸⁹See Prunty, *The Shareholders' Derivative Suit: Notes on Its Derivation*, 32 N.Y.U.L. Rev. 980, 989 (1957); Glenn, *The Stockholder's Suit—Corporate and Individual Grievances*, 33 Yale L. J. 580, 583 (1924) (but it is primarily derivative, *id.* at 584). But see McLaughlin, *The Mystery of the Representative Suit*, 26 Geo. L.J. 878, 901-04 (1938); Note, *Shareholder Derivative Suits: Are They Class Actions?*, 42 Iowa L. Rev. 568 (1957).

the same as other kinds of class suits.⁹⁰ On the other hand, even when the plaintiffs are entitled to request prorata recovery in their complaint, the action must still be viewed as brought in the right of the corporation, and not in the right of individuals.⁹¹ It seems, therefore, that the plaintiffs should be required to comply with the requirements for bringing a derivative suit.⁹² Otherwise, plaintiffs could avoid these requirements simply by requesting direct prorata recovery. Of course, it could be argued that if the plaintiffs failed to obtain pro rata under such a complaint, they should simply be thrown out of court; thus the action might be viewed as nonderivative. However, this would be a poor method of judicial administration. It would be preferable to dispose of the corporate cause of action completely once it is brought before the court, especially in view of the possibility that the plaintiffs may be the only shareholders who desire a prorata recovery.

Since the derivative suit with a prorata recovery, though initially treated as an ordinary derivative suit, is best treated after decree in the same manner as nonderivative class suits, there is good reason to view this as a *sui generis* type of action.⁹³ Because the prorata remedy reaches more equitable results in certain cases,⁹⁴ categorization into any rigid form after the decree is undesirable; in particular, rigid categorization according to the types of class suits provided in Federal Rule 23(a) should be avoided. Thus, if a closely-held corporation is involved, there is no need to apply any kind of class-suit concept to the action after prorata recovery has been decreed.⁹⁵ Furthermore, even though in the ordinary derivative suit a single shareholder who prosecutes the suit with proper competence and vigor⁹⁶ quite adequately repre-

⁹⁰See *Kalven & Rosenfield*, *supra* note 81, at 692 n.26.

⁹¹See *Stevens, Private Corporations* § 167, at 784, 796 (2d ed. 1949); Note, 40 *Calif. L. Rev.* 127, 131 n.40 (1952). But see *Berger*, "Disregarding the Corporate Entity" for Stockholders' Benefit, 55 *Colum. L. Rev.* 808 (1955); Comment, 46 *Ill. L. Rev.* 937 (1952).

⁹²See Note, 40 *Calif. L. Rev.* 127, 131 (1952); cf. *Berger*, *supra* note 91, at 823 (some procedural safeguards in derivative suits should be applied to the individual class suit proposed therein).

⁹³Compare *Pentland v. Dravo Corp.*, 152 F.2d 851, 854 (3d Cir. 1945); *Rahl, The Class Action Device and Employee Suits Under the Fair Labor Standards Act*, 37 *Ill. L. Rev.* 119, 134 (1942) (FLSA class suits are a *sui generis* type of action).

⁹⁴See, e.g., *May v. Midwest Ref. Co.*, 121 F.2d 431 (1st Cir.), cert. denied, 314 U.S. 668 (1941) (large long-settled interests in former corporate assets protected through use of pro rata).

⁹⁵In fact, it may be improper to do so. Cf. *Developments—Multiparty Litigation*, 71 *Harv. L. Rev.* 874, 937 (1958) (size of class).

⁹⁶See *Everett v. Phillips*, 288 N.Y. 227, 233, 43 N.E.2d 18, 20 (1942) (by implication).

sents the interests of all the shareholders, the court should make a fresh analysis of the plaintiff's ability to represent the possibly many divergent interests in the corporation concerning the very issue of whether pro rata should be decreed.⁹⁷

For the purpose of the statute of limitations the normal derivative-suit rule should apply;⁹⁸ then a claimant is not barred because the statute had run on the corporate cause of action prior to the time when he individually submitted his claim.⁹⁹ The opposite rule would permit the defendants to escape liability to many, if not all, claimants simply because the court declared prorata recovery at or near the expiration of the period of limitations. The policy against stale claims certainly would not require this windfall to the defendants, since the commencement of the suit informs them of the possibility of these claims, and indeed of the possibility of the larger liability of a corporate recovery.

The res judicata effects flowing from the pro rata suit must similarly be worked out apart from a preconceived mold. Issues relating to the merits of the claim against the defendants should follow the normal rules of res judicata in derivative suits; that is, absentees should be bound on issues relating to the merits whether or not actually litigated and regardless of the notice sent to them.¹⁰⁰ However, only those to whom notice is sent should be bound by the court's determination to grant prorata recovery.¹⁰¹ If the court rejects pro

⁹⁷For a discussion of these possibly divergent interests, see part II B., *supra*. Thus among those who would ultimately oppose the defendants on the merits there may hardly be a single homogeneous class represented by the plaintiffs. Cf. Comment, 25 Texas L. Rev. 64, 70-73 (1946) (discussion of problem of sub-classes).

⁹⁸See generally Baker & Cary, *Cases and Materials on Corporations* 683-86 (3d ed. 1958) (no statutes distinguished between derivative suits and suits by the corporation, though the former raise special problems); Note, *Statute of Limitations and Shareholders' Derivative Actions*, 56 Colum. L. Rev. 106 (1956).

⁹⁹This same rule is advocated for all class suits: The statute is tolled once suit is brought, and each class member can share in the recovery even though the statute would bar his separate individual suit. See Keffe, Levy & Donovan, *supra* note 51, at 339-42; Gordon, *supra* note 64 at 531 n.79 (advocates tolling even if suit is later dismissed or compromised).

There might be such a bar if the pro rata suit were viewed as resulting ultimately in a kind of "spurious" class action like the suit under federal rule 23(a)(3). See Chafee, *Some Problems of Equity* 267-68, 283 (1950). But see Moore, *Federal Practice* par. 23.12, at 3476 (2d ed. 1948).

¹⁰⁰See *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 956 (1958); Note, 34 Colum. L. Rev. 118, 136-37 (1934). However, notice is required in some jurisdictions when the suit is compromised or dismissed. See, e.g., Fed. R. Civ. P. 23(c).

¹⁰¹See note 51 *supra*; cf. *First Nat'l Bank v. Edwards*, 134 S.C. 348, 132 S.E. 824 (1926). Notice by publication should be sufficient to bind unknown persons. See Keffe, Levy & Donovan, *supra* note 51, at 347-48 (alternative suggestion to jurisdic-

rata, this determination should bind the absentees whether or not notice has been sent, for the primary purpose of this notice is to enable those who oppose the pro rata remedy to argue for a corporate recovery; thus when a corporate recovery is decreed, the ordinary derivative-suit rules should apply.¹⁰² On the issue of damages no

tion by notice alone that the court might take jurisdiction in rem, the res being the class claim, *id.* at 348 n.53); cf. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950) (quasi in rem suit). But see Letter from George W. Pepper to Arthur J. Keefe, 33 Cornell L.Q. 349, 350 (1948) (may need more individualized notice). In the pro rata situation, the only group likely to contain many unknown persons is that of former shareholders, who cannot be harmed by the court's granting prorata recovery, since, without a prorata recovery, they could not share at all in the recovery; furthermore, they will be given the best available post-decree notice. Therefore, binding such persons to a grant of pro rata through notice by publication does not appear prejudicial or unfair.

It is difficult to conceive of a workable remedy for a shareholder who is entitled to individual notice, but does not receive it, and is thus not bound by the decision to grant prorata, rather than corporate, recovery. Perhaps he could seek to enjoin the distribution to the shareholders if it has not yet occurred until he is heard on the question whether to grant prorata recovery; however, this situation is unlikely to occur because such a shareholder is not likely to receive post-decree notice either. Perhaps he could bring a later derivative suit against all who received part of the recovery and against the former defendants for the balance due the corporation on the original cause of action. If the number who received the recovery is large, the suit might be maintained as a class suit against a defendant class. Even if this solution might be accepted as workable—which seems doubtful, a rule of law permitting the question of whether to grant prorata recovery to be relitigated by a single shareholder seems dubious. The corporation itself, which was a party to the original suit, might be held bound by the determination not to grant a corporate recovery. In any event, it does not seem that such a shareholder should be permitted to make any kind of a collateral attack on the judgment in the original suit, whether such attack be made in the same state where the original judgment was rendered or in some other state. However, in order to give some teeth to the notice requirement, perhaps the prorata decree itself should provide for reopening within a given time (e.g., one year) by a shareholder who was entitled to individual notice, but did not receive it. This would not only give effect to the notice requirement, but would provide a definite date for the final termination of the litigation. The foregoing analysis applies with equal force to any other type of individual, such as a bondholder, who might be held entitled to receive individualized notice.

¹⁰²This question of binding effect could arise only if the court failed to give the pre-decree notice that should normally be available if pro rata is requested. Some courts, though, might prefer to avoid the bother of notice if they determine that the case for pro rata is very weak.

Normally it would seem that a corporate recovery would not harm any of the absentees. However, it is true that some absentees might want to argue for pro rata on the ground of foreseeable mismanagement. If the plaintiffs fail to argue properly for pro rata, the proper remedy appears to be intervention on the ground of lack of adequacy of representation. Cf. *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 955 (1958). Furthermore, a corporate recovery *prima facie* protects all the interests in the corporation. On the other hand, if pro rata is decreed and some of the absentees are barred from recovery, these absentees suffer an

problem should arise: if pro rata is decreed, the pre-decree notice should be sufficient to bind all the absentees; if pro rata is not decreed, the ordinary derivative-suit rule that all are bound regardless of notice may be applied.

The question remains whether nonresident absentees, even if they receive proper notice, can constitutionally be bound by a state-court determination whether or not to grant prorata recovery. In the ordinary derivative suit, this problem has never arisen, probably because of the requirement of actually bringing the corporation itself into the suit. However, on the issue of whether to grant pro rata, the usefulness of relying upon the corporate entity vanishes, and divergent interests within the corporation must be considered separately. If the issue of pro rata is raised but a corporate recovery is decreed, the ordinary derivative-suit procedure should be followed. If pro rata is decreed, it may be argued that, even if in some class-action situations state courts could not constitutionally bind nonresident absentees, the state court should be able to bind all here, provided proper notice is given, since it initially acquired plenary jurisdiction over the corporate cause of action. This argument may fail, however, since there is nothing to bar a nonresident from commencing his own deriva-

immediate and irrevocable loss. Therefore, the need for pre-decree notice is far greater when pro rata is ultimately decreed.

It is true that former shareholders might want to argue for prorata, since this is their only way to benefit from the recovery, unless they are restored to the status of present shareholders, for example, though rescission of a sale, see, e.g., *Goodliffe v. Colonial Corp.*, 107 Utah 488, 155 P.2d 177 (1945) (plaintiffs in derivative suit permitted to reestablish selves as shareholders of record). The former shareholders might seem more in need of notice that a corporate recovery is to be granted than do the present shareholders who wish to argue that the case presents a foreseeable mismanagement situation. Nevertheless, they do not seem to have standing to raise the defendants' personal defenses against some present shareholders, even if they might compete with some of the present shareholders after a pro rata decree; and the foreseeable-mismanagement argument is clearly not open to them. Therefore, they should be entitled to pre-decree notice only in the sale-of-control situation and possibly in the subsequent-shareholder situation. In the latter situation, notice might not be essential since the defendants will most likely make the same arguments for pro rata as those available to the former shareholders. However, testimony from some of the former shareholders might be necessary in order to establish the defendants' contention that the injury was done only to the former shareholders, although notice given for this purpose to only some of these former holders should not be determinative of the binding effect of the court's determination upon these absentees. In any event, the former shareholders might have some recourse through ordinary intervention. For discussion of the need for notice to these former holders in order to bind them when pro rata is ultimately granted, see text at notes 53-55, *supra*.

tive suit in another jurisdiction prior to the decree in the first suit.¹⁰³ Moreover, to contend that a court has acquired "primary jurisdiction" is to beg the question of whether the court has the power to bind the absentees once conflicts of interest because of pro rata become possible. In any event, even though there may be some doubt, indications seem to be that state courts can bind nonresident absentees in ordinary class suits,¹⁰⁴ and thus should have the same power here.

V. SOME PROBLEMS IN THE FEDERAL COURTS

A. *Application of the Rule of Erie R.R. v. Tompkins.*¹⁰⁵

In cases in which the corporate cause of action is based upon a state-created right, the question arises whether a federal court that has jurisdiction solely because of diversity of citizenship must follow state law in determining whether to grant prorata recovery. First, let us assume that the highest court of the state in which the federal district court is sitting has held squarely that prorata recovery will not be granted in the type of case before the federal court.¹⁰⁶ It may be argued that the pro rata device is simply one remedy available to a federal court of equity,¹⁰⁷ and that the federal court is free to grant an equitable remedy even though the state court would not.¹⁰⁸ Thus when the case involves a choice among different remedies—corporate recovery versus prorata recovery—rather than the question of the availability of any remedy at all, it might be contended that the fed-

¹⁰³Cf. *Winkelman v. General Motors Corp.*, 39 F. Supp. 826 (S.D.N.Y. 1940) (several suits commenced in federal and state courts within the same state); *Wheaton, Representative Suits Involving Numerous Litigants*, 19 Cornell L.Q. 399, 426 (1934.) *Wheaton* would not permit separate suits by members of the class during the pendency of the class suit. *Id.* at 438. A similar suggestion has been made concerning derivative suits. See *McLaughlin*, *supra* note 89, at 903. However, there may be some difficulty in preventing a nonresident from beginning another suit in another jurisdiction, a point not discussed by either author.

¹⁰⁴See *Hansberry v. Lee*, 311 U.S. 32, 43 (1940) (dictum); *Developments—Multi-party Litigation*, 71 Harv. L. Rev. 874, 940 (1958); Note, 67 Harv. L. Rev. 1059, 1067-68 (1954).

¹⁰⁵304 U.S. 64 (1938).

¹⁰⁶Such a situation might occur in Delaware. See *Keenan v. Eshleman*, 23 Del. Ch. 234, 2 A.2d 904 (Sup. Ct. 1938).

¹⁰⁷Cf. *Spaulding v. North Milwaukee Town Site Co.*, 106 Wis. 481, 496, 81 N.W. 1064, 1069 (1900) (dictum) (granting of prorata recovery involves an equitable power of the court). Even though pro rata is a type of remedy, it does not follow that it must be classified as "procedural" for the purpose of the *Erie* doctrine. Cf. *Sampson v. Channell*, 110 F.2d 754 (1st Cir.), cert. denied, 310 U.S. 650 (1940).

¹⁰⁸See *Guffey v. Smith*, 237 U.S. 101 (1915); cf. *Pusey & Jones Co. v. Hanssen*, 261 U.S. 491 (1923).

eral court should be able to mold its remedy independently.¹⁰⁹ However, it seems that the granting of prorata recovery is not based upon remedial standards, that is, upon a determination of how best to carry out the policy of the underlying liability-determining law. Rather, except in some liquidation situations, the desirability of prorata recovery depends upon prelitigation conduct. In other words, the decision is not as to the desirability of one remedy or another in a given factual situation,¹¹⁰ but rather a determination of whether to transfer the substantive right to the recovery from the corporation to some of its shareholders upon finding certain facts to exist.¹¹¹ Furthermore, even if prorata recovery is considered merely one type of remedy available to a court of equity, its unavailability in the state court may be grounded upon a strongly felt state policy,¹¹² which should be honored in the federal court.¹¹³ Moreover, the state legal rule regarding prorata recovery directs the outcome of the litigation and should therefore bind the federal court.¹¹⁴

This same analysis should lead the federal court to attempt to follow state law when the state decisions have refused prorata recovery in some situations, but are silent concerning the situation before the federal court. Conversely, if in a situation similar to that before the federal court, a state court would grant prorata recovery, it seems that the federal court should be obliged to do the same. This is not a situation in which the federal court would merely close its doors to the plaintiffs, remitting them to the state court.¹¹⁵ Rather, the federal court has assumed jurisdiction over the controversy and therefore

¹⁰⁹See Hart & Wechsler, *The Federal Courts and the Federal System* 652 (1953). The unavailability of any remedy in the state courts, however, closes the doors of the federal courts sitting in the state in diversity cases. See *Angel v. Bullington*, 330 U.S. 183 (1947).

¹¹⁰See *Guffey v. Smith*, 237 U.S. 101 (1915).

¹¹¹See Note, 69 *Harv. L. Rev.* 1314, 1317 (1956).

¹¹²See *Keenan v. Eshleman*, 23 *Del. Ch.* 234, 2 *A.2d* 904 (Sup. Ct. 1938).

¹¹³*Cf.* *Byrd v. Blue Ridge Rural Elec. Coop., Inc.*, 356 U.S. 525, 535-36 (1958) (some indication that in some areas the strength of the state policy may determine whether the federal court must follow the state under *Erie*).

¹¹⁴*Cf.* *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945). It is not clear what law was followed in the *Perlman* case. See *Perlman v. Feldmann*, 219 *F.2d* 173, 178 (2d Cir.), cert. denied, 349 U.S. 952 (1955). In *May v. Midwest Ref. Co.*, 121 *F.2d* 431 (1st Cir.), cert. denied, 314 U.S. 668 (1941), in denying the equitable relief requested and substituting a prorata recovery, the court did refer to the law of the state of incorporation, but it is not clear that this law was determinative.

¹¹⁵For indications that such door-closing may be permissible, see Hart & Wechsler, *op. cit.* *supra* note 109, at 658; *Developments—Multiparty Litigation*, 71 *Harv. L. Rev.* 874, 964-65 (1958).

should be required to follow the state rules regulating liability.¹¹⁶ However, if prorata recovery is urged in a liquidation situation solely as a matter of convenience, the federal court should be free to mold the remedy, provided no person shares in the recovery who would not share if the suit were brought in the state court.¹¹⁷ When the courts of the state have been completely silent, the federal court must attempt to work out its results in accordance with whatever relevant state law it can find.¹¹⁸

If the derivative suit could not have been brought in the state court because of the inability to obtain service upon a nonresident corporation,¹¹⁹ it might be argued that the federal court should not be limited by the state's rules concerning prorata recovery. This argument might prevail if this were a question of whether a particular type of multiparty litigation should be permitted in the federal court when the device is unavailable in the state courts.¹²⁰ In this situation, however, the derivative suit device itself is available in the state courts. Furthermore, since the issue of whether to grant prorata should be determined by state rules governing the underlying liability, the inability to bring the action in the courts of the state in which the federal court is sitting, solely because of service-of-process problems, does not render the *Erie* doctrine inapplicable.¹²¹

A similar argument for federal independence in granting prorata recovery might be made when the federal court obtains jurisdiction of a state-created claim solely through the doctrine of pendent jurisdiction.¹²² However, even though jurisdiction is not based upon diver-

¹¹⁶Cf. *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949) (rationale that state security-for-costs statute creates a new liability).

¹¹⁷Cf. *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 996-98 (1958).

¹¹⁸See generally Hart & Weschler, *op. cit. supra* note 109, at 628-29.

¹¹⁹If venue is laid in the federal courts under 28 U.S.C. § 1401 (1958), extra-territorial service over the corporation in whose behalf the suit is brought may be obtained under 28 U.S.C. § 1695 (1958). See *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 963 (1958).

¹²⁰See *id.* at 997-98. But cf. *Griffin v. McCoach*, 313 U.S. 498 (1941).

¹²¹It is possible that the substantive law of a state other than that of the forum should be applied, since venue may be laid under 28 U.S.C. § 1401 (1958) only because the real defendants reside in the forum; the forum may have had no connection with the alleged wrongful acts. It is arguable that in this situation the federal court should ascertain the proper state law through an independent application of conflict-of-law rules. Cf. Hart & Weschler, *op. cit. supra* note 109, at 633-36. However, *Griffin v. McCoach*, *supra* note 120, may require the federal court to apply the conflicts rule of the forum. If this is true, the federal court would be obliged to apply the law of the forum state if that state regards the rules governing prorata recovery as "procedural." Cf. *Sampson v. Channell*, 110 F.2d 751 (1st Cir.), cert. denied, 310 U.S. 650 (1940).

¹²²See *Hurn v. Oursler*, 289 U.S. 238 (1933).

sity of citizenship, *Erie* requires the application of state substantive law in deciding the state-created right, for state law here operates independently and of its own force, and not merely through adoption by federal law.¹²³ Therefore, the right of the federal court to make an independent determination of the prorata issue, once the federal claim has dropped out of the case leaving only the state claim for decision, must be denied on the same reasoning as that applied in the situation in which the suit could not have been brought in the state court. However, if the federal claim is determined upon a trial, it seems that federally developed rules on pro rata should govern even though the state claim is incidentally adjudicated.

B. Federal Jurisdiction.

Since the derivative suit with prorata recovery should be considered *sui generis*, with some elements governed by the rules of the ordinary derivative suit and others by the rules of ordinary non-derivative class suits,¹²⁴ some question may arise as to the power of the federal court sitting in a diversity-of-citizenship suit to permit non-diverse shareholders to enter the suit to share in a prorata recovery. It seems, though, that once the federal court has obtained jurisdiction over the derivative suit, it should retain jurisdiction until the final relief is granted.¹²⁵ However, since the granting of pro rata involves more than the mere fashioning of a remedy, it might be argued that, for the purpose of federal diversity jurisdiction, the entire suit must be governed by ordinary class-suit rules. Even so, diversity between the original parties of record should be sufficient even though non-diverse class members enter later; this idea of minimal diversity will probably be accepted.¹²⁶

More difficult is the question of jurisdictional amount—especially

¹²³See Hart & Weschler, *op. cit.* supra note 109, at 697. If the plaintiff brings a derivative suit based on a state-created cause of action, but can obtain federal-question jurisdiction because he must rely on federal law in order to prove his case, see *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180 (1921), it still seems that the federal court should be obliged to follow the state rule on pro rata, since the primary duty involved in the case is determined by state law. When, however, the cause of action is based upon federal law, the federal courts should be free to develop their own rules governing prorata recovery.

¹²⁴See text at notes 93-102, *supra*.

¹²⁵Cf. *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921) (bill ancillary to earlier bill maintainable without diversity).

¹²⁶See *Developments—Multiparty Litigation*, 71 Harv. L. Rev. 874, 933 (1958). Professor Moore indicates that nondiverse members of a class can intervene in a spurious class suit after the commencement of the action. 3 Moore, *Federal Practice* par. 23.10, at 3443 (2d ed. 1948).

in view of the recent increase in the requirement.¹²⁷ While it is true that a federal court does not lose jurisdiction of an action simply because the plaintiff fails to recover the jurisdictional amount,¹²⁸ it might be argued that the decreeing of prorata recovery changes the suit into a new type of action for which an independent showing of jurisdiction is required.¹²⁹ If this argument is sound, not only might an aggregate prorata recovery in excess of \$10,000 be required, but possibly each claimant might be required to claim this amount. In other words, solely for the purpose of deciding whether the monetary requirement has been satisfied, the court may have to determine whether the suit has become a "true," "hybrid," or "spurious" class action under Federal Rule 23(a). Only if the suit is considered a "true" class action could the various claims be aggregated.¹³⁰ It is arguable that the shareholders comprising the plaintiff class share a "common" right in the recovery within the meaning of Rule 23(a)(1) relating to true class actions.¹³¹ However, when the defendants may have personal defenses against some of the claimants and when the total amount of the recovery will depend upon the number of shareholders who qualify to share in the recovery, the rights of the claimants should be viewed as "several," thus rendering the suit "hybrid" or "spurious"—probably the latter, although the matter of classification is often extremely difficult.¹³² Even so, in such class suits only the individual claims of the original parties of record need meet the jurisdictional amount.¹³³ Thus small claimants would not be barred from intervening, or participating without intervention,¹³⁴ although there is some indication that in spurious class suits absentees can come in only through intervention.¹³⁵

In order to avoid this tangle, the federal court should look only to the amount claimed by the plaintiff in the complaint, subject to

¹²⁷28 U.S.C. §§ 1331, 1332 (1958).

¹²⁸See Hart and Wechsler, *op. cit. supra* note 109, at 994-95.

¹²⁹See Developments—Multiparty Litigation, 71 Harv. L. Rev. 874, 960 (1958).

¹³⁰See *id.* at 933; Moore, Federal Practice par. 23.13, at 3477-78 (2d ed. 1948).

¹³¹*Cf. Smith v. Swormstedt*, 16 How. 57 (U.S.) 288 (1853) (suit concerning disposition of a pre-existing fund).

¹³²See Chafee, *op. cit. supra* note 99, at 251-56.

¹³³See, e.g., *Ames v. Mengel Co.*, 190 F.2d 344 (2d Cir. 1951); Moore, Federal Practice par. 23.10, at 3443 (2d ed. 1948).

¹³⁴See Kalven & Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. Chi. L. Rev. 684, 712-13 (1941) (advocates participation after the decree, apparently differing from formal intervention).

¹³⁵See *Oppenheimer v. F. J. Young & Co.*, 144 F.2d 387, 390 (1944) (by implication); Rahl, *supra* note 93, at 126, 130 (by implication). Such intervention must probably be before the decree. See Chafee, *op. cit. supra* note 99, at 285.

whatever criteria apply in other actions.¹³⁶ Thus the possible corporate recovery would be determinative.¹³⁷ However, when the plaintiff properly requests prorata recovery in the complaint, the actual prorata share demanded should control. This approach seems justified, since the whole purpose of the action is to dispose of the corporate cause of action once and for all, whatever the kind of recovery ultimately granted. The federal courts could use this sensible approach by viewing the action as *sui generis* and not necessarily within any category of Rule 23(a). Alternatively, if it is felt that, apart from specific statutory authority,¹³⁸ Rule 23 occupies the entire field of class-suit-type actions in the federal courts, the same result can be reached by relying on the categorization of the derivative suit as a true class suit within Rule 23(a)(1). Thus, when the plaintiff properly requests prorata recovery in his complaint, the court could treat the suit as a derivative suit for the proportion of the corporate claim demanded by the plaintiff.¹³⁹

VI. CONCLUSION

The availability of prorata recovery may cast some light upon the nature of the derivative suit, and even of the corporation itself. The prorata remedy does not seem to fit in with any rigid concept of the corporation as an entity distinct from its shareholders, nor with a corresponding conception of the derivative suit.¹⁴⁰ If the corporation possesses a legal personality completely distinct from its shareholders, logically it seems that the status of its shareholders, often the basis for pro rata, should be irrelevant. The slight divergence from the rigid entity approach introduced by the contemporaneous-ownership rule in derivative suits does not appear to preclude the use of the entity theory because the recovery is for the corporation. However, direct

¹³⁶See generally Hart & Wechsler, *op. cit.* supra note 109, at 994-95.

¹³⁷See *Koster v. (American) Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 523-24 (1947) (dictum).

¹³⁸E.g., Fair Labor Standards Act § 16 (b), 52 Stat. 1069, as amended, 29 U.S.C. § 216(b); Rahl, *supra* note 93, at 132, 134 (class suit here a *sui generis* action).

¹³⁹Cf. *Kaufman v. Societe Internationale Pour Participations Industrielles et Commerciales, S.A.*, 343 U.S. 156 (1952) (rationale that the corporation should state a corporate claim on behalf of intervening nonenemy shareholders for the proportion of the assets due to such intervenors). This case is discussed extensively in Berger, "Disregarding the Corporate Entity" for Stockholders' Benefit, 55 *Colum. L. Rev.* 808 (1955).

¹⁴⁰See 4 Pomeroy, *Equity Jurisprudence* §§ 1089, 1091, 1094, 1095 (5th ed. 1941) for a presentation of the entity theory of the corporation and derivative suit. The pro rata problem is apparently ignored. Professor Stevens points out that the pro rata cases should lead to a "reassessment of the merit of the inherited concepts of corporateness." Stevens, *Private Corporations* § 167, at 789 (2d ed. 1949).

recovery by the shareholders through prorata recovery can result only from a disregard of the corporate entity.¹⁴¹ Therefore, rather than attempting to justify the use of pro rata merely on the ground that a court of equity should be able to mold this remedy because of the necessity of an exceptional case,¹⁴² it would seem preferable to fit it in with some general theory of the nature of the corporation and the derivative suit. Thus the corporation should be considered an association of persons "united for a common purpose and permitted by law to use a common name."¹⁴³ The shareholders thus possess a dual legal personality—individual and corporate.¹⁴⁴ The plaintiff shareholder in a derivative suit acts in the latter capacity, the derivative suit being a convenient procedural device designed to avoid a multiplicity of suits by shareholders and to insure that the rights of creditors are safeguarded.¹⁴⁵ Under this view of the corporation and the derivative suit, prorata recovery may be used whenever a more equitable result can be reached by doing so, provided that the supervening rights of creditors are protected.

This equitable device, though, should not be used too freely, since a corporate recovery generally tends to insure that all the interests in the corporation are protected.¹⁴⁶ Furthermore, when the corporation is a going concern, the management of the corporate funds should generally remain in the hands of the corporate managers—the persons appointed by the shareholders to manage their investment.¹⁴⁷ However, prorata recovery should be used to protect the investment of innocent shareholders, as in the foreseeable-mismanagement situation, and to bar shareholders against whom defendants clearly have equitable defenses.

If pro rata is so used, the objection that it tends to encourage fraud¹⁴⁸ seems weak. If the defendants practice fraud or concealment

¹⁴¹See Berger, *supra* note 139. See also Berle, *The Theory of Enterprise Entity*, 47 Colum. L. Rev. 343 (1947) (courts will disregard corporate entities to look to the real enterprise in order to reach realistic results).

¹⁴²See *May v. Midwest Ref. Co.*, 121 F.2d 431 (1st Cir.) cert. denied, 314 U.S. 668 (1941); Ballantine, *Corporations* § 143, at 336 (rev. ed. 1946).

¹⁴³Berle, *supra* note 141, at 352.

¹⁴⁴See Stevens, *Private Corporations* §§ 8, 9 (2d ed. 1949).

¹⁴⁵See *Smith v. Hurd*, 53 Mass. (12 Met.) 371 (1847) (these practical reasons urged as well as those based upon a strict view of the corporate entity).

¹⁴⁶In the liquidation situation, pro rata would afford the same protection. In the sale-of-control situation especially, pro rata may be the only way to protect the interests of a large group, the former shareholders.

¹⁴⁷Cf. Glenn, *The Stockholders' Suit—Corporate and Individual Grievances*, 33 Yale L.J. 580, 587-88 (1924).

¹⁴⁸*Keenan v. Eshleman*, 23 Del. Ch. 234, 253, 2 A.2d 904, 912 (Sup. Ct. 1938).

in order to obtain the shareholder acquiescences relied upon for pro rata a court of equity could hold that the acquiescences were ineffective because not all the facts were known, and thus award a corporate recovery.¹⁴⁹ In the foreseeable-mismanagement situation, it would be highly unrealistic to suppose that the defendants would feel utterly free to mismanage in a grand manner, expecting the plaintiffs to request pro rata in later litigation; there is always the risk that a corporate recovery and a receiver might be demanded. In the sale-of-control situation, it is true that the defendant sellers do keep part of the unlawful "premium" when pro rata is decreed. Thus there is force to the argument that there is some incentive to practice fraud or concealment because of the availability of pro rata; perhaps the suggestion that a full "prophylactic" corporate recovery should be had against the sellers has some merit.¹⁵⁰ However, the rights of former shareholders must be protected, probably through some kind of direct recovery. If prorata recovery is to be allowed solely because of the presence of subsequent shareholders, the defendants may tend to take risks, especially in a corporation with actively traded stock. However, it seems that they could not rely on the availability of pro rata, since many factors might lead to a corporate recovery.¹⁵¹

On balance, prorata recovery, under certain circumstances, provides a useful and desirable method for redressing wrongs to the corporation. Through it, the derivative suit is likely to become a far more refined instrument for achieving corporate justice.

¹⁴⁹Cf. *Holland v. Presley*, 168 Misc. 942, 6 N.Y.S.2d 743 (Sup. Ct. 1938), rev'd on other grounds, 255 App. Div. 667, 8 N.Y.S.2d 804, aff'd mem., 280 N.Y. 835, 21 N.E.2d 884 (1939).

¹⁵⁰See Leech, *Transactions in Corporate Control*, 104 U. Pa. L. Rev. 725, 823-26 (1956).

¹⁵¹See text at notes 34-40, *supra*.