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Stockholders' Derivative Suit: Plaintiffs' Right to Trial by Jury

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size of jury verdicts”; we do think the stage has now been reached where juries are more mature. This author is forced to conclude that when the court in Shingleton spoke of a “candid admission at trial of the existence of insurance coverage,” as opposed to “the questionable ‘ostrich in the sand’ approach,” it was dealing with the substantive question of whether or not insurance coverage is a subject for the jury's knowledge. Accordingly, the court has been inconsistent in its rulings in Shingleton and Beta Eta.

It is this author's opinion, that regardless of the intent of the court in Beta Eta, the effect of its decision will be, for all practical purposes, to override Shingleton. It is unfortunate that the State of Florida apparently will return “to the present rule of non-disclosure—a rule which is not only a fruitful source of controversy, but fails completely to accomplish its purpose.”

STEPHEN T. BROWN

STOCKHOLDERS' DERIVATIVE SUIT: PLAINTIFFS' RIGHT TO TRIAL BY JURY

Plaintiffs, stockholders of a closed-end mutual fund, brought a derivative action in the Federal District Court for the Southern District of New York, naming as defendants the corporation's board of directors and an investment banking firm which acted as the corporation's stockbroker. Both the directors and the broker were accused of breaching the fiduciary duty owed by each to the corporate fund. The broker, some of whose partners comprised a portion of the corporation's board of directors, was also alleged to have thereby violated the Investment Company Act of 1940. This control by the broker was alleged to have been used for the purpose of extracting from the corporation unusually high brokerage fees. Allegations against the directors individually, asserted that they had converted corporate assets and were guilty of “gross abuse of trust, gross misconduct, willful misfeasance, bad faith,” and “gross negligence.” The plaintiffs' complaint requested an accounting of the alleged excess profits received by the broker and of the resulting losses to the corporation and also demanded a jury trial. The defendant's motion to strike

40. Id.
41. Id.
42. Id.
43. Note, Permissive Joinder As A Substitute for Excluding Evidence that Defendant is Insured, 59 YALE L.J. 1160, 1167 (1950).
the demand for a jury trial was dismissed. An interlocutory appeal followed, and the decision of the district court was reversed. On certiorari to the United States Supreme Court held, reversed: Neither the fact that a stockholder's right to a derivative action is founded in equity, nor the fact that the stockholder demands the equitable relief of accounting, will deprive him of the right to a jury trial so long as the underlying facts, as alleged, would give the corporation a cause of action at common law and some money damages are requested. Ross v. Bernhard, 90 S. Ct. 733 (1970).

As early as Dodge v. Woolsey, the United States Supreme Court recognized the stockholders' derivative action. One stockholder was allowed to bring an action for the purpose of barring the collection of a tax alleged to be unconstitutionally levied against the corporation. The court concluded that a bill in equity would lie against the corporation when brought by one of its members, provided that the member alleged a breach of the fiduciary relationship existing between the corporation and its directors. Later, Hawes v. Oakland added two important limitations to this doctrine: The stockholder's right to a bill in equity must be founded on a right of action existing in the corporation itself and he must have exhausted all reasonable means within the corporation to obtain redress of his grievances.

In 1916, the defendants in a stockholders' derivative action made a demand for a jury trial. The Supreme Court, speaking through Justice Holmes, affirmed the lower court's dismissall of their suit. He reasoned that since the plaintiff was requesting triple damages under the Sherman Act and since the act extended the right to a jury trial to defendants sued thereunder, no action under the statute could be maintained in equity. Here was a clear directive by the Supreme Court that a derivative action is only maintainable in equity, and because of this, there is no right to a jury trial. A few months later, in another case under the Sherman Act, stockholders sought relief on behalf of their corporation without alleging any of the elements necessary to give equity jurisdiction; i.e., they requested relief at law. The court answered emphatically that "their remedy is not at law."

The above case, United Copper Securities Co. v. Amalgamated Copper Co., was cited to the same effect in Goetz v. Manufacturers & Traders' Trust Co., wherein the plaintiffs in a stockholders' derivative suit requested a jury trial. Their request was denied because "the action,

7. United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261 (1917).
8. Id. at 264 (footnote omitted).
being brought . . . is not one that falls within the constitutional assurance of jury trial . . ." but instead "is one that arose through the application of equitable rules by courts of chancery . . . ."

Ironically, Richland v. Crandall, one of the last in the long line of decisions denying a jury trial in derivative actions, was decided by the same district court trying the instant case, but with the opposite result, not 13 months earlier. In Richland, the plaintiffs sought relief, both derivatively as well as on their own behalf, requesting in each instance that the issues of fact be tried to a jury. To the extent that they desired their own recovery, a jury was allowed, but as to issues bearing only on the derivative portion of the suit the court stated:

Historically a stockholders' derivative suit has always been one exclusively in equity, even when instituted for the purpose of enforcing, in whole or in part, a corporation's legal claim.

. . . .

The Dairy Queen doctrine does not entitle a derivative stockholder to a jury trial. An essential condition to the invocation of that doctrine is the requirement that plaintiffs state a legal claim (whether or not joined with equitable claims) which they could make the subject of a suit at common law, either at the present time or before the adoption in 1938 of Rule 18(a) F.R.C.P. permitting joinder of legal and equitable claims in one civil action. A derivative action could never be brought as a 'Suit at common law.' Even though it asserts what would be legal claims if asserted by the corporation, it has always been exclusively a suit in equity. Since it could not be brought at common law, it could not meet the test laid down by the Seventh Amendment.\(^12\)

Another stream of thought with regard to the jury's place in equitable proceedings grew up simultaneously with the concept previously discussed. The genesis of this diverging line of reasoning was originally expressed in Parsons v. Bedford, wherein the seventh amendment right to a jury trial was appraised.

When, therefore, we find, that the amendment requires that the right of trial by jury shall [be] preserved, in suits at common law, the natural conclusion is, that this distinction was present to the minds of the framers of the amendment. By common law, they meant what the constitution denominated in the third article 'law'; not merely suits, which the common law recognized among its old and settled proceedings, but suits in which legal rights were to be ascertained and determined, in contra-
distinction to those where equitable rights alone were recognized, and equitable remedies were administered...\textsuperscript{14}

Thus, it appears that the nature of the remedy requested, rather than the "form" of the action in which it is requested, should be the criterion for determining the existence of a right to a jury trial. This dictum, which went far beyond the scope of the case, until recently found little support in the law.

With the adoption of the federal rules of procedure in 1938, the way was paved for legal and equitable issues to be tried simultaneously. "The distinction between law and equity, although abolished by the new rules, is a distinction in procedure and not remedies. What was, before the new rules, an action at law is a jury action and what was a suit in equity is a non-jury action."\textsuperscript{16} This change in policy had its effect on the derivative action under the antitrust laws so that an entirely opposite result than that reached in the earlier case of Fleitman v. Welsbach Street Lighting Company\textsuperscript{6} was obtained in Fanchon & Marco, Inc. v. Paramount Pictures, Inc.\textsuperscript{17}

The two major issues of right of the shareholder to sue and of violation of the anti-trust laws causing damage to the corporation can be tried side by side or otherwise as may be convenient; that one may go to the jury while the other does not causes no difficulty.\textsuperscript{18}

It should be noted that in Fanchon & Marco it was the defendant's right to a jury trial that was in issue. Furthermore, the defendant was entitled to a jury trial by statute so that the stockholder plaintiff, of necessity, had to show that the defendant's jury right was not inconsistent with his (the shareholder's) equitable right to sue under the same statute on behalf of the corporation. Fanchon & Marco made it possible for shareholders to sue on behalf of the corporation in antitrust cases, but the question of the plaintiff's right to a jury in derivative suits, not based on the antitrust statutes, still remained answered in the negative.

Five years later, in Beacon Theatres, Inc. v. Westover,\textsuperscript{10} the counter-plaintiff was awarded a jury trial as to issues that were coincidental to his counterclaim as well as to the plaintiff's equitable request for an injunction. The trial court, with the court of appeals affirming, sought to try all issues bearing on the equitable relief to the court, leaving the residue to the jury when the antitrust question was litigated. Fearing that

\begin{itemize}
\item \textsuperscript{14} Id. at 275 (emphasis added).
\item \textsuperscript{15} Ryan Distributing Corp. v. Caley, 51 F. Supp. 377, 379 (E.D. Pa. 1943).
\item \textsuperscript{16} 240 U.S. 27 (1916).
\item \textsuperscript{17} 202 F.2d 731 (2d Cir. 1953). See also Rogers v. American Can Co., 305 F.2d 297 (3d Cir. 1962).
\item \textsuperscript{18} Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 202 F.2d 731, 735 (2d Cir. 1953).
\item \textsuperscript{19} 359 U.S. 500 (1959); cf. Scott v. Neely, 140 U.S. 106 (1891).
\end{itemize}
this course could bar the counterplaintiff from having all the issues bearing on the antitrust claim tried before a jury, due to the operation of the doctrine of "collateral estoppel," the Supreme Court required that the legal claim be tried first saying:

[T]he justification for equity's deciding legal issues once it obtains jurisdiction, and refusing to dismiss a case, merely because subsequently a legal remedy becomes available, must be re-evaluated in light of the liberal joinder provisions of the Federal Rules which allow legal and equitable causes to be brought and resolved in one civil action... 20

... Only under the most imperative circumstances... can the right to a jury trial of legal issues be lost through prior determination of equitable claims. 21

Going one step further than Beacon is Dairy Queen Inc. v. Wood, 22 wherein defenses purely legal in nature were asserted against a claim for equitable relief. The Supreme Court held that the issues relevant to the legal defense could not be considered "incidental" to the equitable issues involved in the claim and must be tried to a jury before the remaining factual questions may be considered by the court.

Moving still further in this direction was the high court's decision in Simler v. Conner. 23 There, the plaintiff, seeking the equitable relief of a declaratory judgment to determine the amount of fees owed to his lawyer on a contingent-fee retainer contract, was entitled to have all the issues tried to a jury. The holding distinguished the form of the action which 20. Was Beacon Theatres, Inc. v. Westover, 359 U.S. 500, 509 (1959) (footnotes omitted).
21. Id. at 510.
24. 323 F.2d 826 (9th Cir. 1963).

advancing the opposite viewpoint: The
shareholder, even though dependent solely on equity for a judicial airing of his grievances, may nonetheless have a jury where the remedy sought on behalf of the corporation is legal. This was the state of the law when the Supreme Court granted certiorari in the instant case for the purpose of resolving the conflict.

The Court first established the fact that without question "a corporation's suit to establish a legal right was an action at law carrying the right to jury trial at the time the Seventh Amendment was adopted." Since law would not recognize any right on the part of the shareholder to enforce the legal claims of the corporation, equity fashioned the derivative suit. Thus, the Court, citing Koster v. Lumbermens Mutual Casualty Co., stated that the derivative suit has a dual nature: "first the plaintiff's right to sue on behalf of the corporation and second the merits of the corporation's claim itself."

The proposition enunciated in Simler v. Conner provided the next step in the Court's reasoning process. "The Seventh Amendment question depends on the nature of the issue to be tried rather than the character of the overall action." Although the court did not actually say so, they evidently considered that the question of the plaintiff's right to sue was the single element which gave the derivative suit the "overall character of an equitable action." They then reasoned that this question, though one of standing, was no different than any other equitable claim. Since Beacon Theatres and Dairy Queen required that when equitable and legal claims are joined in the same action, the legal claims go to the jury first then the equitable ones are tried by the court, the same principle could be applied to the derivative suit. Thus, "the right to a jury is not forfeited merely because the stockholders' right to sue must first be adjudicated as an equitable issue triable to the court." In other words, the court broke the derivative suit into two parts: the shareholders' standing to litigate and the underlying corporate claim. The corporate claim, so separated, would not be tainted by the equitable nature of the shareholders' standing to litigate. The issues of fact relevant to each could then be tried separately.

To further substantiate the position that the plaintiff's source of standing is irrelevant with respect to his right to assert legal issues before a jury, the court cited with approval several cases awarding jury trials to plaintiffs in a class action.

27. 90 S. Ct. at 735.
29. 90 S. Ct. at 736.
31. 90 S. Ct. at 738. This proposition is far from novel. The honorable Justice Story expressed exactly the same idea as dicta over 150 years ago in Parsons v. Bedford, 28 U.S. (3 Pet.) 266 (1830). See p. 000 & note 14 supra.
33. E.g., Oskoian v. Canuel, 269 F.2d 311 (1st Cir. 1959); Montgomery Ward & Co. v. Langer, 168 F.2d 182 (8th Cir. 1948).
After the rules there is no longer any procedural obstacle to the assertion of legal rights before juries, however the party may have acquired standing to assert those rights. Given the availability in a derivative action of both legal and equitable remedies, we think the Seventh Amendment preserves to the parties in a stockholder's suit the same right to a jury trial which historically belonged to the corporation and to those against whom the corporation pressed its legal claims.\(^4\)

In the instant case, the plaintiff shareholders requested money damages for, among other things, breach of contract on the part of the corporation's broker and gross negligence on behalf of the board of directors. Had the corporation brought these two obviously legal claims in its own name, they would have been triable to a jury. Applying the rule announced above will require that the issues of fact bearing on the shareholders' standing\(^8\) to litigate on behalf of the corporation be tried to the judge; i.e., was there a breach of the fiduciary duty,\(^6\) and did the shareholder make all reasonable attempts to gain redress within the corporation.\(^9\) However, all the remaining issues bearing on the legal claims advanced on behalf of the corporation must go to a jury since the plaintiff so desires.\(^8\) Any unresolved issues of fact stemming from equitable claims made for the corporation are to be referred to the judge after the preceding legal issues have been handled by the jury.\(^8\)

Unfortunately, the decision under consideration can not find much support in public policy. It is obvious that the majority of these cases will involve complex issues which will quite possibly be beyond the reach of the average juror. A judge may find himself forced to administer a class in business administration before he can charge the jury with its fact-finding mission. Worse yet, the jurors may not realize that they do not understand the case and blunder their way through to a verdict which at best would be an uneducated guess.

Awarding a jury trial will invariably increase the cost of the suit and lengthen the trial of cases. When considered in the light of the current cost of a law suit, and the already overburdened dockets of state and federal courts, the concept of jury trials in derivative suits, as a matter of right, loses any appeal it may have held for even the most liberal interpreter of the constitution.

Aside from having little or no basis in policy, the rule does not admit of easy application. The facts of the case at bar will serve to illustrate

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34. 90 S. Ct. at 740.

35. Standing, as used in this note, refers to the shareholders' right to sue for the corporation.


38. There was dictum to the effect that the defendant could also demand a jury, 90 S. Ct. 733 (1970); cf. Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 202 F.2d 731 (2d Cir. 1953).

the difficulty. If the trial court considers the question of the shareholder's standing first, which the Court said it should, issues of fact will be raised with respect to the fiduciary duty toward the corporation. These issues will, more likely than not, be the same as those bearing on the corporation's legal claims which in this case are gross negligence of the directors and breach of a contract negotiated by the corporate fiduciaries. When these issues are tried to the court to determine standing, the doctrine of "collateral estoppel" will prevent them from later going to the jury in the trial of the legal cause, thereby creating the very situation the Supreme Court was so fearful of in Beacon Theatres. The only way to avoid this dilemma is to try the corporation's legal cause first and then determine the question of the shareholder's standing to litigate. Such a procedure would work a grave injustice on the corporate officers who might be called upon unnecessarily to defend a suit where the shareholder is later found to be without standing to litigate.

Thus, it appears that the effects of this decision will be undesirable, and the rule set forth of little practical value. Of course, this alone could not be used to rationalize the denial of what was found to be a constitutional right. Some flaw must appear in the legal reasoning before criticism becomes valid. If all of the court's premises are correct, then no flaw is present. But, it is at least questionable that this is the case. The platform upon which this decision rests is the supposed dual nature of the derivative suit. Upset this idea of duality and the concepts of standing to litigate and the corporate claim will slide together to form one wholly equitable cause of action. There are several ways that the Court could have brought about this result.

The dissenting opinion points to one method which looks to the early history of the derivative suit. That is, derivative actions are in fact suits to enforce a trust. In Attorney General v. Utica Insurance Company, an early action which paved the way for derivative suits, the court declared that recovery on the part of the shareholder was for the beneficial use "of the company at large." Taken in the light of the trust concept, the majority view of duality appears incongruous since under

40. "[T]he right to a jury is not forfeited merely because the stockholder's right to sue must first be adjudicated as an equitable issue triable to the court." Ross v. Bernhard, 90 S. Ct. 733, 738 (1970) (emphasis added). "[T]he court after passing upon the plaintiff's right to sue . . . is now able to try the corporate claim . . . with the aid of a jury." Id. at 739 (emphasis added).

41. The Court inferred that all issues of fact pertinent to the question of standing would be tried to the court, but in DePinto v. Provident Security Life Ins. Co., 323 F.2d 826 (9th Cir. 1963), the court declared that the breach of fiduciary duty question could go to the jury if based on the common law claim of negligence; cf. Halladay v. Verschoor, 381 F.2d 100 (8th Cir. 1967).

42. 2 Johns. Ch. 371* (N.Y. Ch. 1817).

43. Id. at 390.* Prunty says: "To read into this language thoughts of a secondary enforcement of corporate rights is to superimpose a complexity not otherwise apparent." Note, The Shareholders' Derivative Suit: Notes on its Derivation, 32 N.Y.U. L. REV. 980, 989 (1957).
trust law the legal rights of the trust vest in the trustee (director and officer of the corporation) and not the corpus itself (corporation).

The second argument militating against the dualized concept of the derivative suit finds its support in a less scholarly but more practical foundation. Earlier, it was mentioned that in all probability the majority of factual issues relevant to the corporate claim would also bear on the shareholders' standing to litigate. If this be the case, how practical is the idea that the shareholders' claim is a separate suit from the underlying corporate claim? In fact, how can the question of standing stand alone? Without a demand for relief, the issue of standing would not present a justiciable controversy, legal or equitable.

In conclusion, this author appraises the decision as follows: The majority's reasoning appears sound and is easily followed; but the premise that the derivative action is of a dual nature, upon which the court's reasoning is based, can be disputed. Taking this into consideration, as well as the problems attendant to jury trials in complicated corporate litigation, the minority view might have resulted in a better decision. At any rate, the following suggestion is submitted to those defendants desirous of circumventing the effects of the instant case.

A defendant, faced with a demand on the part of the shareholders for a jury trial, can probably avoid having the bulk of the issues go to the jury by asserting the affirmative defense that the shareholder lacks standing to litigate. Such a defense should allege that there has been no breach of the fiduciary duty owed the corporation by the officers and directors. If the allegations in the answer are couched in the proper terms, they will require the judge to weed through and decide nearly every issue of fact relevant to the corporation's claim for relief. Even if the shareholder's standing to litigate is established, the doctrine of collateral estoppel will prevent any of these same issues from later going to the jury. Of course, the success of this technique will depend largely on the nature and complexity of the claim asserted on behalf of the corporation as well as the skillful drafting of the answer.

CHARLES C. KLINE

44. This may not operate in the Ninth Circuit due to the effects of DePinto v. Provident Security Life Ins. Co. 323 F.2d 826 (9th Cir. 1963). See note 41 supra.
45. When there is no genuine issue of any material fact, the corporation may move for summary judgment and achieve the same result.