Shareholders' Derivative Suits in Minnesota: Function and Operation of the Control Requirements

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Shareholders' Derivative Suits in Minnesota: Function and Operation Of the Control Requirements

I. INTRODUCTION

The shareholder's derivative action developed as an equitable remedy to check the abuse of power by corporate management. This peculiar legal phenomenon empowers a shareholder to sue management or third parties on behalf of the corporation, providing a means whereby the management must account for damages inflicted upon the corporation by its misdeeds or failure to enforce valid claims against third parties. Recognizing that some such police power was needed, but fearful that harassment might result from its untrammeled use, the courts have developed a set of requirements intended to function as controls. In Hawes v. Oakland, the Supreme Court es-

2. Depending on the character of the right asserted or the injury complained of, a shareholder's suit may be "direct" or "derivative." Broadly speaking, a direct action arises from acts or transactions upon which a shareholder may sue in his own right and for his own personal benefit. A derivative action, on the other hand, is based upon a right of action not personal to the shareholder-plaintiff but existing in the corporation itself; the shareholder acts as a sort of guardian ad litem for the corporation's interest, while the corporation is nominally cast as a party defendant. Courts generally agree, for example, that a suit by a minority shareholder attempting to block the "freeze-out" of his interest is a direct action, Zahn v. Transamerica Corp., 162 F.2d 36 (3rd Cir. 1947), and that a suit based upon alleged misappropriation of corporate assets by a director is derivative, Hawes v. Oakland, 104 U.S. 450 (1881), but where a suit is brought to compel declaration of a dividend the authorities are divided. In Minnesota, it would be brought as a nonderivative class action. See Mn. R. Civ. P. 23 and Advisory Committee Note (1969). The proper classification of a shareholder's suit is frequently difficult. See Note, Distinguishing Between Direct and Derivative Shareholder Suits, 110 U. Pa. L. Rev. 1147 (1962). No attempt is made in this Note to develop or discuss the distinctions between the respective forms of action or the transactions upon which they may be based, but it should be noted that the control requirements discussed herein apply only to the derivative action.
6. 104 U.S. 450 (1881). Suits by shareholders had arisen prior to Hawes v. Oakland, several of which are reviewed in the Hawes opinion. But prior to its decision in that case the Supreme Court had
established, as conditions precedent to a derivative suit, the requirements of contemporaneous ownership of stock and of prior demands upon the directors and shareholders. Hawes was subsequently incorporated into the Federal Rules of Civil Procedure, and is retained in rule 23.1. In addition to these original requirements, the Federal Rules and the procedural rules of a number of states provide for judicial supervision of dismissals or settlements in derivative actions.

This Note will not attempt a thoroughgoing treatment of all the problems raised by the operation of the control requirements in derivative litigation. Instead, it will review the origin, development, treatment and function of the various controls. Minnesota case law, and related federal case law, are analyzed in detail with a view to understanding the Minnesota court's conception of the derivative suit and the manner in which the control requirements should operate.

II. THE REQUIREMENT OF CONTEMPORANEOUS OWNERSHIP

A. In General

Two basic stock ownership requirements are normally imposed as conditions precedent to bringing a derivative suit. First, by definition the plaintiff must be a "shareholder" at the commencement and for the duration of the action in order to have standing to complain. The law of the state of incorporation determines who is a "shareholder" for purposes of suit, and by not thoroughly analyzed the right of a shareholder to sue in a derivative capacity, and the principles set forth in the Hawes decision have remained essentially unaltered. See Goldstein v. Groesbeck, 142 F.2d 422 (2d Cir. 1944); 3B J. Moore, Federal Practice ¶ 23.1.15[1] (2d ed. 1969). See also Note, Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit, 73 Harv. L. Rev. 746 (1960). State courts were not bound to follow the Hawes ruling as regards the control requirements, and in some cases they did not. See note 25 infra. But the influence of the federal practice, if not dominating, has been weighty. See notes 21 & 48 infra.

7. 104 U.S. at 461.
8. Galdi v. Jones, 141 F.2d 984 (2d Cir. 1944). See generally 3B J. Moore, supra note 6, ¶ 23.1.15[1]. See also Note, supra note 6, at 746.
10. See, e.g., Sorin v. Shahmoon Ind., Inc., 30 Misc. 2d 408, 429, 220 N.Y.S.2d 760, 780 (1961); 3B J. Moore, supra note 6, ¶¶ 23.1.16[3], 23.1.17.
a liberal construction of the term, courts have allowed derivative suits to be brought by beneficiaries of stock held in trust, actual owners of stock held in street names, pledgees of stock, parties who have been induced by fraud to convey their stock to another, legatees with equitable title to the stock and holders of warrants. Courts also recognize a “double derivative” suit, in which a plaintiff holding shares in a subsidiary corporation brings an action on its behalf against the parent.

Second, the federal courts and most state jurisdictions


Plaintiff should have his remedy whether it be regarded as a double derivative or a triple derivative action. The key . . . is the essential fact that control of all three corporations has remained unchanged. In this era of corporate mobility a complaining stockholder should not be required to play a form of shell-and-pea game with a group of dominant directors who control all the corporations involved in the transfers of stock.


Compliance with the contemporaneous ownership requirement may be unnecessary, however, where the suit is based upon a right created by federal statute. Blau v. Mission Corp., 212 F.2d 77 (2d Cir. 1954) (no contemporaneous ownership requirement in an action brought under section 16(b) of the Securities Exchange Act to recover short-swing profits from insider). But see Gottesman v. General Motors Corp.,
acknowledge the “contemporaneous ownership” rule, which requires that a derivative plaintiff must have held his interest at the time of the alleged wrong to the corporation, or that his shares must have subsequently devolved upon him by operation of law. The contemporaneous ownership requirement was first imposed by the United States Supreme Court in Hawes v. Oakland and was intended primarily to prevent the transfer of shares to an out-of-state plaintiff in order that he might gain access to the federal courts. In developing the rule, however, subsequent courts expressed concern about the practice of purchasing litigation, and the secondary purpose of the contemporaneous ownership rule was recognized to prevent plaintiffs from purchasing stock for the sole purpose of instituting litigation in the hope of coercing a private settlement from the defendants. This latter function has been reflected in the widespread adoption of the rule by state courts and legislatures.

Despite its widespread and long-standing acceptance, the contemporaneous ownership rule is not without its faults. In the first place, it has never been clear whether the rule is substantive or procedural. Thus, an Erie problem may arise in

268 F.2d 194 (2d Cir. 1959) (derivative suit based on violation of antitrust law is subject to provisions of federal rule 23b).
21. States which have adopted the contemporaneous ownership requirement either by court rule or statute are listed in 3B, J. Moore, supra note 6, ¶ 23.1.15[2], n.6.
22. 104 U.S. 450 (1881).
23. Id. at 453, 461.
24. While the Hawes Court did not coin the term, it was clearly concerned with the problem of “strike suits.” See Dimpfell v. Ohio & M. R.R., 110 U.S. 209, 210 (1884). A thorough, albeit biased, analysis of the strike suit problem appears in F. Wood, Survey and Report Regarding Stockholders’ Derivative Suits (1944), the report which led to the adoption of the New York “Security for Expenses” statute (see text accompanying notes 138–40 infra).

Federal Courts recognize the dual purpose of the rule. See Bateson v. Magna Oil Co., 414 F.2d 128 (6th Cir. 1969) and Pioche Mines Consol., Inc. v. Dolman, 333 F.2d 257 (9th Cir. 1964) where the court states: “The purpose of [federal rule 23.1] is to protect the courts from collusive actions, and to protect corporations and their officers and directors from strike suits.” 333 F.2d at 265.

26. The Advisory Committee recognized at the time the Federal Rules of Civil Procedure were promulgated that it was uncertain whether the contemporaneous ownership requirement was substantive or procedural. The question was left to be resolved by the courts. Note of Advisory Committee, Rule 23b, Fed. R. Civ. P. (1946 ed.). Fed-
a diversity suit should the law of the state where the suit arose reject the contemporaneous ownership rule. Second, while the requirement of contemporary ownership may limit the opportunities for strike suitors, it has by no means curtailed the practice. Those who specialize in strike suits, it is said, can live with the rule. The problem is a difficult one, and no proposed solution which fails to meet the problem directly can promise to offer a satisfactory answer. Finally, in a very basic sense, to require contemporaneous ownership seems inconsistent with the theory that a derivative suit is brought upon a cause of action belonging to the corporation with any recovery accruing to the corporation and benefiting all shareholders alike.

Whatever the supporting rationale, strict enforcement of the rule will often prevent the trying of meritorious claims.

General courts generally treat the contemporaneous ownership rule embodied in federal rule 23.1 as a rule of procedure and apply it accordingly. If, however, the rule were viewed as substantive in character, the Erie doctrine would require that state law, if in conflict with the federal rule, be controlling. Several courts have recognized that the possible conflict presents a serious problem, but it should probably be noted that those jurisdictions opposed to the prevailing view constitute a dwindling minority. See generally, 3B J. Moore, supra note 6, ¶ 23.1.01[4], 23.1.15[2].

28. See note 26 supra.
29. 3B J. Moore, supra note 6, ¶ 23.1.15[2].
30. See generally Hornstein, New Aspects of Stockholders' Derivative Suits, 47 Colum. L. Rev. 1, 7 (1947). Occasionally an attempt is made to justify the rule on some other ground as well. Some authorities contend that the rule is fundamentally derived from equitable principles which stop a shareholder from complaining of transactions occurring prior to the time he acquired his interest. 3B J. Moore, supra note 6, ¶ 23.1.15[2]. Among the propositions advanced in this regard are: (1) that the purchaser of stock should acquire only the rights of the vendor, who could not have sued upon transactions in which he participated as a wrongdoer or to which he had "consented," United Elec. Sec. Co. v. Louisiana Elec. Light Co., 68 Fed. Rep. 673 (E.D. La. 1895), and (2) that the purchaser should have no standing to complain of prior acts since any damages caused thereby would already have been accounted for in a lowered purchase price for the stock. Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N.W. 1024 (1903). See also Note, Stockholder's Derivative Suit Complaining of Transactions Occurring Prior to His Acquisition of Stock Under the Iowa Rule of Civil Procedure, 32 Iowa L. Rev. 81, 83 (1946). To state, however, that a purchaser of stock has no greater rights than his vendor merely begs the question. To assume that the purchase price reflects any damage the corporation may have sustained ignores the fact that the harm caused by wrongful acts may be realized only after considerable delay. Furthermore, the passage of time tends to eliminate qualified shareholder-plaintiffs, especially where trading in the stock has been heavy.
31. See Kaufman v. Wolfson, 1 App. Div. 2d 555, 556, 151 N.Y.S.2d
Of course, if the rule is intended only to limit the jurisdiction of the courts, the question of its application would be, and should be, independent of any consideration of the merits of the claim. But to the extent that the rule owes its origins to the fear of purchased litigation, the merits of the claim should not be ignored. In this context, there would seem to be no reason to preclude a suit by someone who purchased stock without knowledge of the wrong and before the damage was manifest. The need for such an approach might be obviated by a determination that the wrong does not "occur" until discovered. A better approach, however, might be to allow a plaintiff who knew of the wrongful act to sue if (1) he has made a bona fide and substantial investment or (2) he can show that no lawsuit was contemplated at the time he purchased stock and that the true extent of the damage was not then apparent, or that by the time the damage became apparent there existed no qualified shareholder willing to undertake the litigation. The rule should be carefully applied with a view to its underlying rationales and should be avoided when its only real effect would be to shield wrongdoing management.

In fact, the development of the contemporaneous ownership rule indicates judicial recognition that without some modification the rule would be a crude tool, overly broad in its impact. State courts have allowed intervention by shareholders who do not meet the contemporaneous ownership test.

530, 532 (Sup. Ct. 1956). See also Dykstra, supra note 3, at 94.

32. A parallel concept is applied in fraud cases where a statute of limitations is interposed as a defense. In Holmberg v. Armbrecht, 327 U.S. 392 (1946), Justice Frankfurter wrote:

[W]here a plaintiff has been injured by fraud and "remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute [of limitations] does not begin to run until the fraud is discovered, though there be no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party" [citations omitted].

327 U.S. at 392. See also Janigan v. Taylor, 344 F.2d 781 (1st Cir. 1965); Lenhart v. Lenhart Wagon Co., 210 Minn. 164, 298 N.W. 37 (1941) (see note 127 infra); Hornstein, Rights of Stockholders In New York Courts, 56 Yale L.J. 942, 953 (1947).

recognize the "continuing wrong" theory, under which a derivative plaintiff may complain of a wrong which commenced before he became a shareholder if the wrong "continues" in the sense that it has not been consummated at the time of the suit.\textsuperscript{44} A leading case on this point is \textit{Maclary v. Pleasant Hills, Incorporated},\textsuperscript{45} involving the issue of stock to the directors of the corporation without adequate consideration. Subsequent to the resolution authorizing the issue, but prior to the execution and delivery of the certificates, plaintiffs became equitable owners. The court held that the suit was not barred by the Delaware contemporaneous ownership statute since the transaction was not completed until the certificates were actually issued.\textsuperscript{46} In \textit{Palmer v. Morris}\textsuperscript{37} a stockholder was allowed to complain of

\begin{itemize}


36. [W]hile the statute should be construed so as to reasonably effectuate its primary purpose—to discourage a type of strike suit—it should not be construed so as to unduly encourage the camouflaging of transactions and thus prevent reasonable opportunities to rectify corporate aberrations. . . .

. . . This statute was not passed to prevent the correction of corporate wrongdoing. It was designed principally to prevent the purchasing of stock to be used for the purpose of filing a derivative action attacking transactions occurring prior to such purpose . . . .

. . . [T]o consider this transaction as having been completed prior to the issuance of the certificates would sanction an application of the statute not required by its language and not fairly required to effectuate its purpose. . . .

35 Del. Ch. at 43, 109 A.2d at 833.

37. 316 F.2d 649 (5th Cir. 1963). See also Bateson v. Magna Oil Co., 414 F.2d 128 (5th Cir. 1969), where the court applied \textit{Palmer v. Morris} in sustaining a noncontemporaneous stockholder's complaint which alleged that the defendant director had caused the corporation to pay him excessive salaries, to advance him money on open account and to mortgage its property as security for his personal indebtedness. The complaint also alleged that defendant made excessive use of the corporation's airplane and mismanaged certain of the corporation's properties. The language of the opinion suggests that under the court's view of the continuing wrong theory, an action could be maintained although the stock was purchased with the intent to sue. 414 F.2d at 130.
contracts entered into prior to his acquisition of the stock where payments under the disputed contracts were continuing at the time he acquired his interest. The court found that the transaction had not "completely occurred . . . prior to plaintiff's acquisition of his stock."\textsuperscript{38} Other courts, however, have taken a contrary view on the same issue,\textsuperscript{39} and the doctrine itself has often been questioned.\textsuperscript{40}

Without applying the continuing wrong concept as such, the court may still accept evidence concerning previous acts where such evidence tends to disclose a continuing conspiracy harmful to the corporation, or to provide a frame of reference for evaluating subsequent acts in their true perspective.\textsuperscript{41} It has been stated that the cover-up of the original wrong is a new and independent wrong, upon which a shareholder may bring suit.\textsuperscript{42}

\textbf{B. In Minnesota}

In all essential respects, rule 23.06 of the Minnesota Rules of Civil Procedure\textsuperscript{43} is a copy of federal rule 23.1. As amended in 1968, it requires the plaintiff to allege either that he held shares at the time of the acts complained of or that his shares

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  \item \textsuperscript{38} 316 F.2d 649, 650 (5th Cir. 1963).
  \item \textsuperscript{39} See Goldie v. Yaker, 78 N.M. 485, 432 P.2d 841 (1967): "We distinguish the agreement as to price and payments on the price pursuant to the agreement . . . . The wrong complained of was in entering the contract, not in carrying out the contract once it was entered." Id. at 487, 432 P.2d at 843.
  \item \textsuperscript{41} Several states, however, have adopted something similar to the continuing wrong concept through legislation. See, e.g., Cal. Corp. Code, \textsuperscript{\textsuperscript{44}} § 834 (West 1955); Ohio Rev. Code Ann. \textsuperscript{\textsuperscript{45}} § 2307.311 (Baldwin Supp. 1966); Wis. Stat. Ann. \textsuperscript{\textsuperscript{46}} § 180.405 (1957). These statutes require that a derivative-plaintiff's ownership of shares be shown as of the time of the transaction "or any part thereof." A Pennsylvania statute gives the court jurisdiction to entertain a suit by a shareholder who cannot meet the contemporaneous ownership requirement if it finds there is a strong prima facie case for the claim asserted and circumstances which threaten serious injustice if the suit may not be maintained. Pa. Stat. Ann. tit. 15, 2852-516 (Supp. 1966).
  \item \textsuperscript{42} Gluck v. Unger, 25 Misc. 2d 554, 202 N.Y.S.2d 864 (Sup. Ct. 1947).
  \item \textsuperscript{43} Rule 23.06, Derivative Actions by Shareholders or Members.
\end{itemize}
devolved upon him thereafter by operation of law.\textsuperscript{44} This adoption of the contemporaneous ownership requirement represents a new development in the law of Minnesota. The issue had been raised in some early cases but the court had never felt compelled to decide the question.\textsuperscript{45} It is significant that the old rule 23.02 of the Minnesota Rules of Civil Procedure, which became effective January 1, 1952, paralleled the former federal rule 23(b) but omitted the provisions relating to contemporaneous ownership of stock.\textsuperscript{46} It may be assumed that the rulesmakers did not consider contemporaneous ownership to be a requirement in Minnesota at that time. In any event, the question had not been determined, and, since no case arose upon the point, it remained an open question until the revision of the Minnesota

\textsuperscript{44} Minnesota courts traditionally have allowed a liberal interpretation of the terms "share" and "shareholder." In Baldwin v. Canfield, 26 Minn. 43, 1 N.W. 261 (1879), a case which predates even Hawes v. Oakland, the Minnesota Supreme Court recognized that pledgees of stock, as well as actual shareholders, have an interest sufficient to maintain an action to prevent the wrongful transfer of corporate assets to third parties. The double derivative suit was recognized in Singer v. Allied Factors, Inc., 216 Minn. 443, 13 N.W.2d 378 (1944) which, as originally commenced, was a derivative action charging directors with wrongful transfers of corporate assets. The plaintiff held no shares in the corporation for which relief was sought; his standing was based upon shareholdings in another corporation which held preferred stock in the "injured" corporation.

\textsuperscript{45} In Venner v. Great N. Ry., 117 Minn. 447, 136 N.W. 271 (1912), a shareholder complained that certain company officers, in violation of the corporate charter and state law, had caused the company to invest heavily in various securities and real properties not necessary or appropriate to the operation of the railroad, and that, in addition, they were managing these investments to their own benefit. The court stated that on the facts alleged the plaintiff might be entitled to a sale of the properties for the benefit of the stockholders, and that it was "unnecessary to determine" whether the plaintiff could question the propriety of certain transactions which had occurred prior to his acquisition of stock. The court would not face the issue squarely, but noted that "upon the suggested question the authorities are not in harmony." 117 Minn. at 457, 136 N.W. at 275. In National Power & Paper Co. v. Rossman, 122 Minn. 355, 142 N.W. 818 (1913), the defendant, while a director of the corporation, had fraudulently induced it to purchase materials from his accomplices at greatly inflated prices. Payments were made in part by issuing stock. After the defendant resigned as director, the corporation instituted an action against him, but collusively dismissed it shortly thereafter. A group of stockholders then intervened and succeeded in vacating the dismissal. The court refused to dismiss those who failed to show contemporaneous ownership, noting that one of the intervenors had apparently owned shares since the inception of the corporation. The court implied, however, than even in absence of that fact the action may have been allowed.

\textsuperscript{46} See M. Pirsig, MINNESOTA PLEADING ¶ 420, n.85 (Rev. 4th ed. 1956). Rule 23.02 is set out at note 69 infra.

As the comment to rule 23.06 indicates, the contemporaneous ownership provision was inserted to prevent a person from buying stock solely for the purpose of maintaining a shareholder's suit.\(^4\) This is weak justification for a strong rule. As already noted, not only does the rule fail in its announced purpose, but the problem to which it is addressed has never been manifest in Minnesota. Perhaps the rulesmakers were primarily motivated by a desire to bring the Minnesota Rules of Civil Procedure into line with those of the federal courts. There is, however, little to recommend the adoption of a rule so intimately associated with the peculiar jurisdictional problems of the federal courts. Considering the hardships the rule may place upon shareholders with meritorious claims, it is to be hoped that the application of the rule will be consistent with the reasons for its adoption in Minnesota. Where a particular case presents none of the dangers associated with purchased litigation, relaxing the contemporaneous ownership rule should not impair its fundamental purpose. Perhaps upon a re-evaluation of its position, the Minnesota Supreme Court would expunge the contemporaneous ownership requirement altogether.

III. THE REQUIREMENT OF A DEMAND UPON DIRECTORS

A. IN GENERAL

The requirement of a demand upon the directors is fundamental to the concept of a derivative suit. A shareholder may not preempt a course of action properly to be taken by the directors. Only after the proper representatives of the corporation have failed in their duty to act in its behalf does the shareholder's right to act arise.\(^4\)

Aside from considerations of theoretical consistency, a number of practical functions may be served by requiring the share-

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47. "[Rule 23.06] requires that the plaintiff be a shareholder at the time of the transaction of which he complains or that his share was obtained by him by operation of law. The purpose is to prevent persons from purchasing stock solely for purposes of maintaining shareholders' derivative actions." Advisory Committee Note—1968, supra note 2.
holder to approach the directors. The demand may serve to enlighten directors who are unaware of the wrongs alleged or supply them with critical information on the issue. If the board is aware of the wrong but hesitant to act, a demand by shareholders might precipitate the action desired. Conversely, the board may be able to show the complaining shareholder that his information was erroneous or his conclusions mistaken, and a lawsuit might thereby be avoided. But in any case, the making of a demand points out the dissatisfaction among the shareholders, and should motivate the board to consider the merits of the particular complaint and the range of responses that may be warranted. Perhaps the cumulative effect of such demands, as indications of the shareholders' vigilance, would in itself serve to discourage wrongdoing.49

Different questions are raised concerning the effect of directors' response to a shareholder's demand. If the directors themselves sue, a derivative action is automatically precluded since the shareholder's right to sue arises only after the corporation has failed to act.50 Should the directors decide that no suit is warranted, however, a shareholder's suit would still be precluded if it appears that the board's decision was a legitimate exercise of business judgment, consistent with its fiduciary duty to the corporation and shareholders.51 Most courts respect the directors' business judgment and will not interfere with decisions concerning business matters, regardless of whether the directors' judgment proves correct. Thus, a corporation may forego action on a valid claim against a third party if it can offer a valid business reason for so doing.52 Nonetheless, the directors, as fiduciaries, are duty bound to protect the corporation and their discretion is limited in that respect. They may not acquiesce where damage has been wrongfully inflicted or exonerate the wrongdoer.53 Thus, in most jurisdictions, the decision not to prosecute a director for fraud, even if made by

49. On the latter point, see Note, supra note 48.
50. Cf. Singer v. Allied Factors, 216 Minn. 443, 13 N.W.2d 378 (1944). See also, Stadin v. Union Elec. Co., 309 F.2d 912 (3rd Cir. 1962), where, in the face of evidence indicating that the officers had taken some action and might consider further action, the complaint was found insufficient.
a disinterested majority of the board, would not automatically bar a subsequent shareholder’s suit. 54

Even where the directors lack the power to prevent the shareholder’s contemplated action, the demand requirement is desirable in view of the benefits inherent in such a procedure and the relatively slight burden it imposes upon the complaining shareholder. In addition, the requirement should not be so strictly applied that any technical failure in compliance therewith would deprive the shareholder of standing, regardless of the merits of his claim. Thus, it is generally acknowledged that the requirement need not be imposed when it is apparent that a demand would be only a futile gesture, 55 as where a majority of the directors are personally involved in the alleged wrongdoing or where the particular director charged is also the controlling shareholder. 56

54. A shareholder may still ask the court to determine whether the acts of which he complains constituted fraud rather than the exercise of business judgment. Even where a disinterested majority of directors concludes that the party charged is innocent of fraud or wrongdoing, or that the disputed transaction was within the legitimate scope of his discretion, a complaining shareholder may still be able to get at least a preliminary hearing on the fraud issue merely by asserting the claim in court. Two Minnesota cases illustrate the point. In Boyum v. Jordan, 146 Minn. 66, 178 N.W. 158 (1920), the plaintiff, formerly the manager and controlling shareholder, charged one of the trustees with taking secret profits during a reorganization. The remaining trustees were convinced that the claim was groundless but the court entertained the suit, reviewing all the evidence before concluding that the trustees’ evaluation was correct. In Warner v. E.C. Warner Co., 226 Minn. 565, 33 N.W.2d 721 (1948), a director of a holding company, pursuant to authority requested and received from the board of directors, sold certain stockholdings belonging to the company at the prevailing market price. A shareholder charged the director with waste of the corporate assets, alleging that he concealed the fact that the “book value” of the stock substantially exceeded the market price, and that the stock was increasing in value. There was, however, no evidence that the director had benefited in any way from the sale, and the court found that the decision to sell the stock was a bona fide exercise of business judgment. That conclusion terminated the litigation, for no action will lie where the evidence establishes no more than error or misjudgment. But again, the court had to review the entire case in order to determine whether the acts complained of amounted to actionable fraud or waste. While the courts traditionally have respected management’s judgment in business matters, they apparently have been less willing to let the managers have the final word in evaluating each other’s culpability.

55. Cathedral Estates, Inc. v. Taft Realty Corp., 228 F.2d 85 (2d Cir. 1955). But a mere allegation that a demand would be futile is not in itself enough. Robison v. Caster, 356 F.2d 924 (7th Cir. 1966).


Recognizing these principles, federal rule 23.1 does not specifically require a demand, but the plaintiff must allege any efforts he has made to obtain the desired action and the reasons for failure to obtain the action, or, where appropriate, the reason for failure to make the efforts. The courts have generally exercised discretion in deciding whether a particular complaint alleges efforts sufficient to meet the requirement or conditions sufficient to excuse it. As a result, such matters are currently judged by widely varying standards.

B. IN MINNESOTA

Although the existence of the director demand requirement has always been acknowledged in Minnesota, a reading of the earlier cases reveals that the shareholder's failure to make a demand does not necessarily preclude maintenance of a derivative suit. It has long been presumed that if the alleged fraud implicates a majority of the board, or a director who is the controlling shareholder, a demand would be meaningless and need not be made. The court's respect for management's judgment

(S.D.N.Y. 1966) (one hostile director controlled the board; taken together, the defendants were also the majority shareholders); Rothwell v. Robinson, 39 Minn. 1, 38 N.W. 772 (1888).

58. See generally 3B J. Moore, Federal Practice, ¶ 23.1.19 (2d ed. 1969). A few courts have been dissatisfied with what would seem to be rather detailed and particular allegations describing the plaintiff's good faith efforts to make an effective demand. See Long v. Stites, 88 F.2d 554 (6th Cir.), cert. denied, 301 U.S. 706 (1937); Gunn v. Voss, 154 F. Supp. 545 (D. Wyo. 1957); 3B. J. Moore, supra, ¶ 23.1.19. Similarly, courts have occasionally adhered to the requirement even where the complaint clearly indicated that demand would be futile. Id. ¶ 23.1.19 nn.22, 23. Most courts, however, do not preserve the ritual to the point of requiring absurd demands. Id. ¶ 23.1.19 n.19.

60. See Rothwell v. Robinson, 39 Minn. 1, 38 N.W. 772 (1888).

61. See, e.g., Savory v. Berkey, 212 Minn. 1, 2 N.W.2d 146 (1942); Briggs v. Kennedy Mayonnaise Products, Inc., 209 Minn. 312, 297 N.W. 342 (1941); Weiland v. N.W. Distilleries, Inc., 203 Minn. 600, 281 N.W. 364 (1938); Anderson v. Campbell, 176 Minn. 223, 297 N.W. 342 (1932); Burns v. Essling, 154 Minn. 304, 191 N.W. 899 (1923); Seitz v. Michel, 148 Minn. 474, 181 N.W. 106 (1921); Tasler v. Peerless Tire Co., 144 Minn. 150, 174 N.W. 731 (1919); National Power & Paper Co. v. Rossman, 122 Minn. 355, 142 N.W. 818 (1913); Venner v. Great N. R.R., 117 Minn. 347, 138 N.W. 271 (1912); Fendille v. State Farmers' Mut. Hail Ins. Co., 74 Minn. 67, 76 N.W. 1026 (1898); Rothwell v. Robinson, 39 Minn. 1, 38 N.W. 772 (1888).
in business matters is also firmly established. But where the majority of the board, in response to a shareholder's demand, acknowledges the fraud of one of the directors but refuses to take action, the court has allowed the shareholder to proceed. In Shaw v. Straight a director had persuaded the rest of the board to issue and exchange a substantial block of stock for the assets of a partnership in which he had an interest. When the assets were later found to be worthless, the plaintiff demanded that the directors rescind the issuance of the stock and nullify its transfer to the defendant. The directors declined to act. The court held that the directors had no discretion to refuse to protect the shareholders and the corporation from fraud, and that their refusal to act did not bar the shareholder's action. This result clearly reflects sound policy. Where a corporation has suffered considerable damage at the hands of a director, a board acting in good faith would not exonerate the wrongdoer without offering compelling reasons for so doing. As the Shaw court indicated, the directors' failure to take action might in itself be viewed as a breach of the duty to protect the corporation. It may also indicate that the board was derelict in failing to investigate the transaction sufficiently. At the least, an un-


63. 107 Minn. 152, 119 N.W. 951 (1909).

64. The court's analysis is confusing, however. Although it treated the action as derivative, the court suggested that the shareholders had a right of action of their own, and that no demand would have been necessary. The court also stated, incorrectly, that upon a cause of action accruing to the corporation the directors refusal to bring suit would be final unless a majority of the shareholders opposed it. 107 Minn. at 160--61, 119 N.W. at 954.

65. The fact that the transaction complained of was fraudulent and operated to the damage and injury of the stockholders of the corporation made it the duty of the officers thereof to bring an action in compliance with the request of plaintiffs. . . . If the duty of the officers to protect the stockholders and the corporation from the fraud of others, it cannot well be said to be discretionary with them whether to perform that duty . . . .

explained failure to act may be taken as evidence of the board's impropriety, and should not preclude a shareholder from acting in the corporation's behalf.

The Minnesota Rules of Civil Procedure, in accord with the federal rules, require a plaintiff to allege "with particularity" the efforts which he has made to obtain the action he desires from the directors and his reasons for failure to obtain the action or to make the effort. To date, the only case dealing with the application of the Minnesota rule is Winter v. Farmers Educational & Cooperative Union, involving a cooperative organization which had become inactive. In an action commenced by members of the cooperative, the president was charged with misappropriating corporate funds to his personal use. The plaintiffs further alleged that the question of restoration of the funds withdrawn without authority was brought to the attention of the board of directors, which failed to take action to recover the money. The answer interposed defendant's counterclaim for past salary due, and the case was tried on the issue of the debt. The plaintiff prevailed at trial, but on appeal the defendant raised the issue that the action was derivative and that the complaint had failed to meet the demand requirements of rule 23.02—the predecessor of the present rule.

While indicating that such an objection, if made at the trial level, "would have been fatal to the complaint," by reading the complaint in conjunction with the record, the court found sufficient allegations of plaintiffs' reasons for failing to make the formal demand. The language of the opinion implies, how-

66. MINN. R. CIV. P. 23.06 (1968).
68. Id. at 260, 107 N.W.2d at 229.
69. Rule 23.02 provided:
In an action brought to enforce a secondary right on the part of one or more shareholders in a corporation or members in an unincorporated association because the corporation or association refuses to enforce rights which may properly be asserted by it, the complaint shall set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders or members such action as he desires, and the reasons for his failure to obtain such action or the reason for not making such effort.
M. PIRSIG, MINNESOTA PLEADING ¶ 420 (rev. 4th ed. 1956).
70. Winter v. Farmers Educ. & Co-op. Union, 259 Minn. 257, 265, 107 N.W.2d 226, 232 (1961). See also Hodgson v. Duluth, H. & D. R.R., 46 Minn. 454, 49 N.W. 197 (1891) (demurrer is proper where complaint fails to show that it was impracticable for plaintiffs to move the corporation itself to bring the action).
71. The record disclosed that: (1) the matter had been discussed at a board meeting at which the defendant presided; (2) the defendant
ever, that had the case involved an "ordinary business corporation," rather than a loose and neglected cooperative, a more strict compliance with the demand requirement would have been expected.\(^7\)

Upon close analysis it appears that Winter really creates no new law. The court acknowledged that while a demand should ordinarily be made,\(^7\) it is not necessary when the wrongdoers constitute a majority of the board,\(^7\) or, by clear implication, a sufficiently dominant minority.\(^7\) This is consistent with previous Minnesota case law.\(^7\) What the Winter court meant by implying that a more stringent demand requirement would have been imposed in a case concerning an ordinary business corporation is not altogether clear. The court's analysis of the basis for the demand requirement indicates that a clear and explicit demand should be made in any case where a probability exists that the directors might be willing and able to respond effectively.\(^7\) There would seem to be no reason, however, to require any more action than was actually taken by the plaintiffs in the Winter case. In such a case, if the court is dissatisfied with the allegations, it should allow the plaintiff to amend the complaint.\(^7\)

admitted taking the funds but claimed his action was justified; (3) defendant would not voluntarily return the funds; (4) defendant challenged plaintiffs to sue for recovery; (5) at least one of the directors then present refused to take part in any lawsuit against the defendant; (6) the plaintiffs in the shareholders' suit included two members of the board, and (7) at trial no justification for defendant's appropriation of the funds could be shown. 259 Minn. at 266, 107 N.W.2d at 233.

\(^7\) Id. at 267, 107 N.W.2d at 233-34.

\(^7\) Noting that the derivative suit is recognized as an extraordinary remedy, the court said:
The demand upon the managing directors and shareholders is important in that it gives the management of the corporation an opportunity to consider the merits of the dispute and to determine, in the interests of the corporation and shareholders, whether it might be disposed of without the expense and delay of litigation. The demand requirement as a condition precedent to a shareholder's derivative suit is one not lightly to be dispensed with.

\(^7\) Id. at 267, 107 N.W.2d at 233.

\(^7\) See note 73 supra.

\(^7\) Cf. Pioche Mines Consol. v. Dolman, 333 F.2d 257 (9th Cir. 1964) (complaint supplemented by affidavit); Lynam v. Livingston, 287 F. Supp. 520 (D. Del. 1968) (supplemental complaint).
IV. THE REQUIREMENT OF A DEMAND UPON SHAREHOLDERS

A. IN GENERAL

The additional requirement of a demand upon shareholders, which also dates from the formative years of the derivative suit, was grounded primarily upon the theory that all possible avenues of internal solution should be explored and exhausted before the parties bring their grievances into court. While the shareholders do not "manage" the corporation, they are capable, at least in theory, of effecting remedial action of several kinds. For example, it has been suggested that the majority shareholders might wish to ratify the act complained of, thus erasing the cause of action completely. Alternatively, they could attempt to induce the directors, through informal pressure, to take the action desired. Failing that, they could elect a new board of directors who would take remedial action against the wrongdoers of the old board. A demand on the shareholders may also be based on the belief that, absent an internal solution, some or all of the shareholders might wish to join as derivative plaintiffs, thereby increasing the plaintiffs' chances of success and weakening any inference that the suit has only nuisance value.

At present, the shareholder demand requirement is recognized in the federal courts and those of most states. The de-


mand is to be made “if necessary,” a reservation which reflects, in part, the power of the shareholders to ratify the acts of the directors. But where the alleged wrong cannot be ratified, or can be ratified only by unanimous vote, the complaining shareholder's right to sue presumably could not be affected by the failure of the shareholders to respond as a body, or even by their affirmative decision not to sue. Courts have generally concluded that no demand is necessary in such a case. As a second major exception to the rule, courts recognize that a demand upon shareholders personally involved as wrongdoers, as with a demand upon interested directors, would amount to idle ceremony. Therefore, such a demand is not generally considered to be “necessary.”

In a third group of cases, usually involving large public corporations, the shareholder demand requirement has been

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85. This is the phrasing adopted by the court in Hawes v. Oakland, 104 U.S. 450, 461 (1881), and codified in rule 23.1, FED. R. CIV. P. (1968), and rule 23.06, MNN. R. CIV. P. (1968).

86. See generally 3B J. Moore, supra note 59, ¶ 23.1.19; Stickells, supra note 78; Note, supra note 48.


A few courts have held to the contrary, requiring that a demand upon the shareholders be made in all cases. The extreme position was taken in Massachusetts, where the court justified the rule on the grounds that a disinterested majority of shareholders has the absolute power to decide not to sue even if it is powerless to ratify the wrong. Solomont & Sons Trust, Inc. v. New England Theatres Operating Corp., 316 Mass. 99, 93 N.E.2d 241 (1950); Pomerantz v. Clark, 101 F. Supp. 341, 344 (D. Mass. 1951). Subsequent federal cases have indicated, however, that the Massachusetts rule is something less than absolute. See Halprin v. Babbitt, 303 F.2d 138 (1st Cir. 1962) (court found the corporation had given its “tacit approval” to the suit); Levitt v. Johnson, 334 F.2d 815, 819 (1st Cir. 1964), cert. denied, 379 U.S. 961 (1965) (Solomont rule not applicable to derivative suit maintained upon a federally created right); Heit v. Brown, 47 F.R.D. 33 (D. Mass. 1967) (necessity for immediate action).

Other courts, while maintaining that a demand is required in all cases, also state that a negative and disinterested shareholder vote would not necessarily preclude continuation of the derivative action, especially where the vote was equivalent, in effect, to an attempt to ratify fraud or illegal acts. Rogers v. American Can Co., 187 F. Supp. 532 (D.N.J. 1960); Abraham v. Parkins, 36 F. Supp. 233 (W.D. Pa. 1940); Smith v. Dunlap, 269 Ala. 97, 111 So. 2d 1 (1959); Escoett v. Aldercress Country Club, 16 N.J. 438, 109 A.2d 277 (1954).

Even under the Massachusetts rule, a negative shareholder vote is effective as a bar only if the shareholders so voting were disinterested. Braunstein v. Devine, 337 Mass. 408, 149 N.E.2d 628 (1958).

88. See generally 3B J. Moore, supra note 59, ¶ 23.1.19.
found unnecessary because it would be unreasonable under the circumstances. Some courts have lifted the requirement, stating that the effort and expense involved in making a demand upon numerous and widely dispersed shareholders would be an unconscionable burden to the plaintiff. It has also been recognized that the management of a publicly held corporation may achieve "working control" of shareholder meetings while holding considerably less than a majority of the voting shares.

In a practical sense, the demand would be superfluous if opposed by the minority in control. Some courts have also suggested that a shareholder demand should not be required if the majority shareholders lack the power to compel the corporation to sue or if it would necessitate delay under circumstances which threaten imminent and irreparable damage.

When all of the exceptions to the shareholder demand requirement are considered together, the doctrine retains little vitality. If the demand is only required when: (1) a dis-
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An interested majority is available to consider the complaint; (2) the acts or transactions complained of are within the power of the majority to ratify, and (3) the directors have failed to take any remedial action, it is evident that the requirement will be invoked in very few cases. Demand upon shareholders may sometimes perform useful functions but in view of the tremendous burden such demands may entail and the rather limited benefits that reasonably may be expected thereby, the value of the demand as a procedural requirement is open to serious question. Several states have abolished the requirement by statute.

B. In Minnesota

Rule 23.06 of the Minnesota Rules of Civil Procedure requires a plaintiff to allege his efforts to obtain action from the shareholders, "if necessary" or allege with particularity his reasons for failing to make the demand. In Winter v. Farmers Educational Cooperative Union, the court acknowledged the two main exceptions to the rule, that "a demand should be made upon the shareholders unless they are powerless to ratify the wrong alleged or unless the majority of their number is interested."

It is clear that under Minnesota law, a majority cannot ratify the directors' fraud or breach of fiduciary duty, so it follows that no demand is required in such a case. Moreover, most of the Minnesota cases involve close corporations, in which the directors are usually in a position to consider and act upon shareholder complaints.

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94. In fact, a demand upon shareholders is now rarely required. See 2 G. Hornstein, supra note 51, ¶ 717.
95. See Note, supra note 48, at 748.
96. See Dykstra, supra note 79.
98. See note 43 supra.
100. Id., at 267, 107 N.W.2d at 233.
101. See, e.g., Schmid v. Ballard, 175 Minn. 138, 220 N.W. 423 (1928); Rothwell v. Robinson, 39 Minn. 1, 38 N.W. 772 (1888). It also appears that ultra vires acts may not be ratified over the objection of an injured minority. West Duluth Land Co. v. Northwestern Textile Co., 176 Minn. 588, 224 N.W. 245 (1929); Naftalin v. LaSalle Holding Co., 153 Minn. 482, 190 N.W. 887 (1922). Where the interest of the minority is adequately protected, however, it may not enjoin a reasonable course of action taken by the majority. Paterson v. Shattuck Arizona Copper Co., 186 Minn. 611, 244 N.W. 281 (1932). Ratification may be inferred from long-term acquiescence to the ultra vires acts. Boyum v. Johnson, 127 F.2d 491 (8th Cir. 1942).
rectors and majority shareholders are frequently one and the same. Since Winter would require a demand only where a majority of disinterested shareholders have the power to ratify the wrong alleged, the requirement is rarely invoked.\footnote{102}

The Minnesota court has not decided whether a shareholder demand will be excused in cases involving large corporations whose shareholders are numerous and widespread. In addition, it has not decided whether the existence of working control in the hands of a minority of shareholder-wrongdoers will obviate the need for a demand.\footnote{103} Should such a question be presented, it is to be hoped that the court would consider first the merits of the complaint, evaluating the necessity of a shareholder demand requirement in view of the burdens it would impose upon the parties affected and the benefits it might reasonably be expected to produce. Having traditionally been protective of the rights of minority shareholders, there is presently little to suggest that the Minnesota courts would be disposed to adhere rigidly to the requirement of a demand upon shareholders.

V. JUDICIAL SUPERVISION OF DISMISSAL OR COMPROMISE

A. IN GENERAL

Both tradition and sound public policy dictate that a plaintiff should be allowed to settle or compromise his claim as he sees fit. However, the derivative plaintiff enforces the right of the corporation rather than his own, and thus the proceeds of the litigation properly belong to the corporation.\footnote{104} Furthermore, in a derivative action, a final judgment or a court approved settlement operates as res judicata to the corporation and all shareholders.\footnote{105} Therefore, to allow the individual plaintiff the un-

\footnote{102. In no reported case has the Minnesota court denied relief or dismissed a complaint on the grounds that the plaintiff failed to demand action from the shareholders.}

\footnote{103. Minnesota has recognized that a demand need not be made upon the directors when the board is sufficiently "dominated" by a wrongdoing minority. Winter v. Farmers Educ. Cooperative Union, 259 Minn. 257, 266, 107 N.W.2d 226, 235 (1961) (see text accompanying note 75 supra); Shaw v. Staight, 107 Minn. 152, 119 N.W. 951 (1909) (see text accompanying note 63 supra).

104. See, e.g., Singer v. Allied Factors, 216 Minn. 443, 13 N.W.2d 378 (1944); Clarke v. Greenberg, 296 N.Y. 146, 71 N.E.2d 443 (1947).}

\footnote{105. Stella v. Kaiser, 218 F.2d 64 (2d Cir. 1954); Barrett v. Shambeau, 187 Minn. 430, 245 N.W. 830 (1932). See also Butler v. Butler Bros., 186 Minn. 144, 242 N.W. 701 (1932).}
conditional right to settle a derivative claim would not only be illogical but would encourage strike suits and collusive settlements. Accordiingly, at a relatively early stage in the development of the derivative action some courts recognized and asserted the power to supervise dismissals. Accordingly, at a relatively early stage in the development of the derivative action some courts recognized and asserted the power to supervise dismissals. Accordingly, at a relatively early stage in the development of the derivative action some courts recognized and asserted the power to supervise dismissals...
provides that a final settlement requires court approval and authorizes the court to require that notice of any proposed dismissal or compromise would serve the best interests of the company and its shareholders. This grant of discretionary power has not gone unused. In order to gather data upon which to evaluate a proposed settlement or compromise, some courts have undertaken their own investigations or appointed referees or special masters for that purpose. In one case, the judge went so far as to assemble the shareholders in open court to ascertain their reaction to the proposal.

In practice, however, the power to supervise settlements is not in itself sufficiently extensive to permit the court to control all possible abuse of the derivative action. It should be recognized, for example, that a substantial portion of any settlement will commonly be received by the plaintiff as an allowance for personal expenses and reasonable attorneys' fees. If the stockholder is presumed to act on behalf of the corporation, it follows that he, like the directors, should be free to accept a reasonable settlement. But the practice of allowances, while it favors settlements, may also encourage a self-serving lawyer to provoke litigation upon claims of questionable merit, in hope of generating income. The court should maintain strict vigilance in

or compromise shall be given to shareholders . . . in such manner as the court directs.” FED. R. Civ. P. 23.1 (1968).
In appraising a proposed settlement the court may evaluate such factors as the attorneys' fees proposed, the damage suffered by the corporation, the responsibility of the defendants for the loss, their ability to respond in damages, the marginal cost to the corporation of continued litigation, and any other relevant factor. Note, 54 HARV. L. REV. 833, 838 (1941). The court must consider all the relevant facts, 3B J. MOORE, supra note 110, ¶ 23.1.24[2], and may approve a settlement over the objection of the complaining parties. Abramson v. Pennwood Investment Corp., 392 F.2d 759 (2d Cir. 1968); Masterson v. Pergament, supra.
113. See Note, 54 HARV. L. REV. 833, 839 (1941).
118. See McLaughlin, supra note 107, at 426.
awarding attorneys' fees, but the problem remains a difficult one to control.120

Judicial control is incomplete in other ways as well. The defendants' purchase of the complaining shareholder's stock would not normally be viewed as a settlement,121 since in theory, it would have no legal effect upon the merits of the lawsuit. In reality, however, it might serve to rid the defendants of the only shareholder qualified to sue or sufficiently contentious to call them to account. The court is also powerless to prevent an abandonment or discontinuance or to coerce a plaintiff who ceases to actively prosecute, although in such cases the court might attempt to induce other shareholders to take up or re-open the action.122 In addition, a recent opinion of the Second Circuit concludes, in effect, that federal rule 23.1 does not preclude a private out-of-court settlement by the corporation of a claim which is the subject of a pending derivative action.123

119. Cf. Certain-Teed Products Corp. v. Topping, 171 F.2d 241 (2d Cir. 1948), where a shareholder-plaintiff who had consented to a summary judgment upon payment of $5,000 to his attorney was held liable to the corporation for the amount of $5,000 less "reasonable" attorney's fees. See also Haudek, supra note 107, at 784.

120. "Making it easier for the legitimate plaintiff and harder for the illegitimate is a problem which will never be wholly solved, but some progress can be made." Douglas, Directors Who Do Not Direct, 47 Harv. L. Rev. 1305, 1327 (1934).


The shareholder may still have the right to challenge the action of the directors in releasing the corporation's claims, in either the original or a new derivative action. Frequently, however, such a change in the posture of the action will reduce the shareholder's likelihood of success. See generally Comment, Compromise of Derivative Claims by a
The power to supervise settlements should be diligently, systematically and creatively cultivated. Unlike the web of rules designed to obstruct the potential derivative plaintiff, the power to supervise settlements focuses directly upon the strike suit problem by minimizing whatever opportunities the defendants may have to pacify the plaintiff. The judiciary should supervise all out-of-court settlements—especially where the attorneys' fees alone are substantial. The use of referees and special masters should also be encouraged. Whenever the circumstances indicate that the contending parties might ignore the interests of the corporation, the court should enjoin the negotiation of a settlement in any form and attempt to determine whether other shareholders would be willing to join as plaintiffs. The derivative action is itself an unusual proceeding, and the unusual and persistent problems it presents do not readily succumb to oblique attacks.

B. IN MINNESOTA

The Minnesota Supreme Court has established that the mechanism of a collusive dismissal will not be permitted to shield fraud. In National Power & Paper Company v. Rossman, the court vacated the collusive dismissal of an action in which the corporation—through its directors—had charged a former director with misappropriation of assets. Holding that the action could not be dismissed without due regard for the best interests of the corporation, the court allowed shareholders to reopen the action in derivative form.
The Minnesota Rules of Civil Procedure, adopting the terms of the corresponding federal rule, expressly provide for judicial supervision of settlements. While no cases have arisen under the Minnesota rule, the cases discussed above illustrate the court's willingness to protect the innocent shareholder from fraud or overreaching and to reopen a legal dispute when equity so demands. Similar policy considerations should warrant the exercise of discretionary power to supervise settlements if the same interests may thereby be protected. This is not to assume that the court should discourage all private settlements. Much of the litigation in Minnesota involves close corporations, where, as noted, a private settlement may be singularly appropriate. To the extent the court could require that any such settlement adequately compensate the minority shareholder for his interest, it should do so. By the same token, the court should assert its power of supervision aggressively where the interests of a greater number of shareholders are affected.

VI. OTHER CONTROLS
A. ALLOCATION OF COSTS AND ATTORNEYS' FEES

Consistent with the theory that a derivative suit is an action brought on behalf of the corporation, the successful plaintiff should be reimbursed by the corporation for his expenses and attorneys' fees. The corporation presumably would have incurred costs of a similar nature had the directors brought suit. As a practical matter, absent some provision for reimbursement, the derivative suit would be reduced to a luxury available solely to the wealthy. Under one interpretation of the common law, the shareholder may be reimbursed only if the outcome of the suit confers pecuniary benefit to the corporation. Minnesota, however, is one of a number of jurisdictions that allows reimbursement when the action results in any "substantial" benefit to the corporation. In Bosch v. Meeker Cooperative Light & Power Association, following a determination that an election of directors and a proposed amendment

128. Rule 23.06, Derivative Actions by Shareholders or Members.
129. See text accompanying note 117 supra.
130. See generally Hornstein, note 117 supra.
131. See, e.g., Burley Tobacco Co. v. Vest, 165 Ky. 762, 178 S.W. 1102 (1915); Roth v. Robertson, 64 Misc. 343, 118 N.Y.S. 351 (Sup. Ct. 1909).
132. See Hornstein, supra note 117, at 798. See also text accompanying notes 88-94 supra.
133. 257 Minn. 362, 101 N.W.2d 423 (1960).
to the bylaws were illegal, the court allowed the plaintiff a reasonable amount to reimburse his expenses. While noting that reimbursement might not be desired wherever a shareholder prevailed, the court maintained that a shareholder should be permitted—in fact induced—to redress a wrong even though such action might not result in pecuniary benefit to the corporation. This test permits inquiry into all aspects of the effects of the litigation. 134 Without attempting to define a standard, the Bosch court stated somewhat redundantly that a substantial benefit must be “more than technical in its consequence.” 135

In contrast, the court denied a successful shareholder-plaintiff’s request for attorneys’ fees in Aiple v. Twin City Barge & Towing Company. 136 Prior to the development of the litigation, the plaintiff had blocked a proposed recapitalization plan, which by statute would have required a two-thirds vote. The corporation then attempted to raise capital by exchanging certain of its assets for stock in a subsidiary corporation, but the plaintiff successfully claimed that the transaction violated his statutory rights. 137 Evidence indicated that the corporation did need additional capital, but the plaintiff and the directors suffered long-standing disagreements and the plaintiff had an interest in a competing firm. The plaintiff then brought supplementary proceedings and moved for summary judgment to recover attorneys’ fees incurred in prosecuting the action. The Minnesota Supreme Court affirmed the denial of the motion and remanded the case to the district court to determine whether the action had been brought in good faith and whether a substantial benefit had accrued to the corporation. Noting that

134. Among the benefits courts have recognized as “substantial” are:
   (a) cancellation of a proposed stock issue which would have upset certain shareholders’ voting rights;
   (b) temporary injunction restraining the corporation from paying certain sums of money;
   (c) cancellation of a stock option plan;
   (d) rescinding of share purchases by a corporation;
   (e) enjoining of ultra vires acts.


In re E.C. Warner Co., 232 Minn. 207, 45 N.W.2d 388 (1950), dealing with the indemnification of a director who successfully defends himself on the merits, also reveals a broad view of corporate benefit. The court maintained that the vindication of officers was itself a benefit to the corporation, although the actual decision was grounded upon other considerations. See Comment, 53 Minn. L. Rev. 1055 (1969).

135. 257 Minn. at 366, 101 N.W.2d at 427.
136. 279 Minn. 22, 154 N.W.2d 898 (1967).
137. Aiple v. Twin City Barge & Towing Co., 274 Minn. at 38, 143 N.W.2d at 374 (1966).
the point was made in Bosch that a stockholder's success in an action against the corporation does not of itself warrant an award of attorneys' fees, the court stated that the fees and expenses of a minority shareholder suing to enforce his statutory rights should not be chargeable to the corporation where the results benefit the shareholder personally rather than the corporation.

B. Security for Expenses Statutes

While Minnesota has no "security for expenses" statute, the subject warrants discussion, as it represents one current approach to the problem of strike suits. Security for expenses legislation was pioneered in New York, following a study which concluded that the existing controls had failed to prevent "the growth of a veritable racket" in strike suits. The New York statute provides, in effect, that a derivative plaintiff whose stock interest amounts to less than 5 percent of the outstanding shares and less than $50,000 in market value, is required at the option of the defendants to provide security for the defendants' expenses, including attorneys' fees. This type of statute has not escaped criticism. First, the security requirement is based solely upon the shareholdings of the derivative plaintiff, taking no account of the possible merits of his claim.


Over a dozen states have now enacted security for expenses statutes. See Dykstra, supra note 134, at 88-89.

139. Special Committee on Corporate Litigation of the Chamber of Commerce of the State of New York, supra note 138, at 1.


See Hornstein, notes 136 & 138 supra.
Second, by its terms, the statute discriminates against the small shareholder, imposing neither burden nor liability on a shareholder whose interest meets the specified standard. It may be that a substantial investor in the corporation is less likely to bring a nuisance claim, and it cannot be doubted that legislation of this kind deters strike suitors, but its most significant effect is to create a barrier to shareholder suits—regardless of their merits. Such an effect inevitably protects wrongdoing management, and has in fact, been labelled as an attempt to insulate corporate management from investors who discover that the corporation has been looted.

In comparison, the California statute applies equally to large and small investors, thus avoiding the arbitrary discrimination inherent in a statute of the New York type. Security is limited to a maximum of $25,000, and need be posted only after the court has determined (1) that there is no reasonable probability that the corporation will benefit from the litigation of the claim, or (2) that the defendant requesting security was not personally involved in the transaction in dispute. However, the plaintiff is not entitled to discovery privileges until after a motion for security has been disposed of and without the aid of discovery a plaintiff may be unable to resist such a motion successfully. In addition, the California law exposes the plaintiff to liability for the expenses of any defendant, whether corporate insider or third party.

Management's answer to the strike suit problem may be simply to bar shareholders from the courts, but in the absence of rampant and widespread abuses by shareholders, security for expenses legislation can best be explained as a preference for management's interests. In Minnesota, such legislation would run counter to the needs and spirit of the law.

VII. CONCLUSION

It has been said that courts seem to define the control requirements in light of their own conceptions of the desirability of the derivative suit remedy. This analysis has a certain
appeal. Certainly it is true that shareholder-litigants have been greeted with varying degrees of hostility and enthusiasm. Neither reaction is unsupportable but the proper rationale would be to reconcile the two. Although abuse of the action has occurred, shareholders have accomplished the desired result of policing the corporate system.\textsuperscript{148}

The indiscriminate tightening of control requirements in order to curb abuses, however, is to subordinate the basic policy of the derivative suit. Without ignoring the legitimate interests of management, the Minnesota court has been consistently cognizant of the interests of the small shareholder. The sound policies underlying the controls have not been ignored, yet a flexible approach to the technical structure of the derivative suit evidences a judicial recognition of the importance of such actions. It may seem rather anomalous, then, that the most significant recent development in the law of Minnesota has been the adoption in 1968 of the contemporaneous ownership requirement by the Court, \textit{sua sponte} and without any demonstrated need for the rule. It is to be hoped that this development does not reflect a growing hostility toward shareholders' suits, and that the court will use its powers in such a way as to develop the effectiveness of the derivative action.

\textsuperscript{148} See Brendle v. Smith, 46 F. Supp. 522, 526 (S.D.N.Y. 1942); Rostow, \textit{To Whom and For What Ends are Corporate Managements Responsible?}, in \textit{The Corporation in Modern Society} 49 (E. Mason ed. 1959); Dykstra, \textit{supra} note 134, at 74.