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THE SHAREHOLDERS' DERIVATIVE SUIT AND THE CONSTITUTIONAL RIGHT TO TRIAL BY JURY

Prior to the recent United States Supreme Court decision in *Ross v. Bernhard*,[1] the question of whether there is a constitutional right to trial by jury in a shareholders' derivative suit had been, with one major exception,[2] historically answered in the negative.[3] However, in *Ross*, the Court eschewed the traditional view and held that the seventh amendment guarantees a right to trial by jury in those derivative suits where the corporation, had it been suing in its own right, would have been entitled to a jury trial.[4] While the significance of *Ross* in the narrow field of derivative suits is hardly minor, its more general application to the elusive question of the constitutional right to trial by jury in civil actions is of much greater importance. *Ross*, the latest of an unbroken line of Supreme Court decisions, which collectively expand the seventh amendment right to trial by jury,[5] confirms the Court's continuing reluctance to be bound by either procedural or substantive doctrines which place a premium upon purely historical considerations.[6] Moreover, the logic of *Ross* and its

[1] 396 U.S. 531 (1970).

[2] DePinto v. Provident Security Life Ins. Co., 323 F.2d 826 (9th Cir. 1963), *cert. denied*, 376 U.S. 950 (1964), *critically reviewed in* Comment, *The Right to Jury Trial in a Stockholder's Derivative Action*, 74 YALE L. J. 725 (1964).

[3] 13 W. FLETCHER, PRIVATE CORPORATIONS §§ 5931, 5990 (rev. vol. 1961) [hereinafter cited as FLETCHER]; 5 J. MOORE, FEDERAL PRACTICE ¶ 38.38 (2d ed. 1969) [hereinafter cited as MOORE].

[4] 396 U.S. at 532-33.

[5] The most important of which are Dairy Queen Inc. v. Wood, 369 U.S. 469 (1962) and Beacon Theatres, Inc. v. Westover, 359 U.S. 500 (1959).

[6] *But see* FED. R. CIV. P. 38(a) stating that the right to trial by jury "as declared by the seventh amendment . . . shall

post-1938 forerunners reveal an accelerated drive towards redefinition of the scope of the right to trial by jury, based not upon elusive historical distinctions between law and equity, but upon more substantive practical considerations.

Two primary reasons traditionally have been given for the view that there is no right to trial by jury in a shareholders' derivative suit. First, application of the so-called "historical test" indicates that the suit was not "a suit at common law" within the meaning of the seventh amendment. The test embraces two distinct inquiries, an affirmative answer to either of which compels acknowledgment of the parties' right to jury trial: whether the particular action was recognized by the common law of England in 1791; and whether, although the action was in fact nonexistent either at law or in equity in 1791, its nature is such that it would have been recognized at common law had it in fact existed in 1791.[7] A negative response to the initial inquiry clearly is mandated by the fact that the shareholders' derivative suit was not recognized even in equity until approximately 1830,[8] at which time it was independently recognized in both England and the United States.[9] The second inquiry, as pertinent to the derivative suit, also traditionally has been answered in the negative, although the supportive reasoning often has been

be *preserved* to the parties inviolate." (emphasis added) U.S. CONST. amend. VII states: "In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by jury, shall be otherwise reexamined by any Court of the United States, than according to the rules of the common law."

[7] MOORE ¶ 38.05; *see* Comment, *Declaratory Judgments—Jury Trial—Identifying "Legal" and "Equitable" Issues and Mode of Trial of "Mixed" Issues*, 45 ORE. L. REV. 210, 213 (1966).

[8] Prunty, *The Shareholders' Derivative Suit: Notes on Its Derivation*, 32 N.Y.U.L. REV. 980, 994 (1957).

[9] *Id.* at 993-94.

less than persuasive.[10] However, the basis of this answer is identical with the second reason usually assigned for the view that there is no right to jury trial in a shareholders' derivative suit—the belief that the equitable interest of the shareholder through which he is given standing to complain characterizes the entire suit as equitable.[11] Thus, whether the suit is described analytically as a singular equitable cause of action or as a combination of the respective claims of the shareholders and the corporation,[12] the entire suit is controlled by the equitable nature of the shareholders' claims.

However, in *Ross*, several factors logically combined to mandate the Court's rejection of historical principles as a dialectic test of the nature of an action and its application of a more practical "basic nature of the issue" test[13] of which

[10] The source of the difficulty has been that theories most frequently advanced to explain the shareholders' derivative suit have failed to account adequately for the mode of its operation. *See, e.g.*, Note, *Stockholders' Suits in Behalf of the Corporation for Wrongs of the Directors to the Corporation*, 3 VA. L. REV. 62 (1915).

[11] Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949) in which the Court concluded:

> Equity came to the relief of the stockholder, who had no standing to bring civil action at law against faithless directors and managers. Equity however, allowed him to step into the corporation's shoes and to seek in its right the restitution he could not demand in [*sic.*] *his own.*

See Comment, *supra* note 2, at 730.

[12] These two views marked the fundamental difference between the logic applied by the *Ross* majority and that applied by the dissent. 396 U.S. at 545-49 (1970).

[13] Though the Court adopted it in varied form, this test was originally suggested by Professor Moore. MOORE ¶ 38.16. Although adopted by several courts in original form, Professor Moore's test has been chiefly criticized for its failure to provide guidelines for determination of the basic nature of the issues. James, *Right to a Jury Trial in Civil Actions*, 72 YALE L.J. 655, 691 (1963).

historical considerations were only one aspect.[14] While the Federal Rules of Civil Procedure purported only to "preserve"[15] the seventh amendment right to trial by jury, the procedural changes thereby wrought clearly undercut the basis of a portion of equity's concurrent jurisdiction with law and thus effectuated a practical expansion of the jury right.[16] Secondly, analysis of the nature of the derivative suit indicated that earlier courts, with the exception of the Court of appeals[17] for the Ninth Circuit had erred in their construction of the suit as a singular equitable cause of action.[18] The suit is actually dual in nature, embodying two claims—that of the shareholders against the corporation and that of the corporation against the third party defendant.[19]

In support of this latter reasoning, which is itself indispensable to the holding in *Ross*, the court relied upon *Koster* v. *(American) Lumbermens Mutual Casualty Co.*,[20] where Mr. Justice Jackson said:

> The cause of action which such a plaintiff brings before the court is not his own but the corporation's. It is the real party in interest and he is allowed to act in protection of its interest somewhat as 'next friend' might do for an individual, because it is disabled from protecting itself.[21]

It will be noticed that the logic of this reasoning compels the conclusion that the duality of the shareholder is horizontal

[14] 396 U.S. at 538 n.10.
[15] FED. R. CIV. P. 38(a).
[16] James, *supra* note 13, at 688; Comment, *supra* note 2, at 736.
[17] DePinto v. Provident Security Life Ins. Co., 323 F.2d 826 (9th Cir. 1963), *cert. denied*, 376 U.S. 950 (1964).
[18] *See, e.g.*, Ross v. Bernhard, 403 F.2d 909, 914 (2d Cir. 1968), *rev'd*, 396 U.S. 531 (1970). *See also* 38 U. CIN. L. REV. 582, 584 (1969).
[19] FLETCHER §§ 5941.1, 5946, *citing* Taormina v. Taormina Corp., 32 Del. Ch. 18, 78 A.2d 473 (Ch. 1951).
[20] 330 U.S. 518 (1947).
[21] *Id.* at 522-23 (footnote omitted.).

only, inasmuch as the shareholder's action is merely the means to the assertion of the corporate claim. More specifically, the remedy of the shareholder is the assertion of the corporate claim.

While, from a practical viewpoint, the *Koster* logic may suffice to surmise the result of a shareholder's derivative suit, it is of little assistance in explaining the source of the shareholder's standing to assert a corporate cause of action. It would appear that giving the shareholder standing to assert a corporate claim runs afoul of traditional notions of the corporation's separate legal personality.[22] Conversely, if equity looks behind the corporate form as a legal entity distinct from its shareholders[23] and thus grants the shareholder the right to sue for an injury to the corporation or standing to sue the third party defendant (in *Ross,* the directors of the corporation) as a representative of the stockholders as a class,[24] it is guilty of conveniently burying and resurrecting the corporate form as matters of pure expediency. Specifically, these latter two theories fail to account for the fact that the corporation is a necessary party to the litigation;[25] to compel recognition of the corporation as a party to the action and subsequently to deny its existence is *non sequitur.*

A solution to this dilemma, though hardly articulated by either *Koster* or *Ross,* is apparent nevertheless in what is perhaps the best description of the theory of the shareholders' derivative suit:

> The stockholders have a right in equity to compel the assertion of a corporate right of action against

[22] Moran v. Vreeland, 81 Misc. 664, 143 N.Y.S. 522, 526 (Sup. Ct. 1913) is typical of the many state decisions which have labored with the problem.

[23] FLETCHER § 5945.

[24] McLaughlin, *The Mystery of the Representative Suit,* 26 GEO. L.J. 878, 901 (1938).

[25] FLETCHER § 5945.

> the directors or other wrongdoers when the corporation wrongfully refuses to sue. The suit is thus an action for specific enforcement of an obligation owed by the corporation to the stockholders to assert its rights of action when the corporation has been put in default by the wrongful refusal of the directors or management to make [*sic*] suitable measures for its protection.[26]

Thus, the shareholder is not asserting any cause of action, either his own or the corporation's, against the third party defendant. Rather, the stockholder merely asserts his own equitable right against the corporation, which actually is joined as a defendant. The corporation thereby is compelled to enforce specifically its own rights and, as the real party at interest,[27] is realigned fictionally as a plaintiff asserting the corporate claim against the third party defendant. Thus analyzed, the duality of the shareholders' derivative suit is patent; and, while it correctly may be said to rest upon a fiction, that fiction is, at its essence, nothing other than that of the corporation as a separate legal entity. Moreover, this reasoning avoids the unfortunate gloss of *Koster* and offers logical consistency, comporting perfectly with both the principle of separate corporate personality and historical standing requirements.

The real need for a theoretically sound analysis of the shareholders' derivative suit was not felt largely until the Court was confronted with the issue in *Ross*—the constitutional right to trial by jury. A majority of the courts, which previously had passed upon the issue, had conceived the suit as a unitary equitable cause of action and, applying the standard historical test, had answered the question in the nega-

[26] FLETCHER § 5941.1, at 414 (footnote omitted.), *citing* Ashwander v. Tennessee Valley Authority, 297 U.S. 288 (1936).

[27] Koster v. (American) Lumbermens Mut. Cas. Co., 330 U.S. 518, 522-23 (1947).

tive.[28] However, application of the dual nature logic to the jury issue manifestly yields the possibility of a contrary result. At common law, a corporation, suing a wrongdoer, enjoyed the right to trial by jury where an individual would have enjoyed that right.[29] Recognition of the dual nature of the shareholders' derivative suit necessarily entails an understanding of the fact that it is the corporation which asserts the corporate claim against the third party defendant. It follows that, as to an otherwise legal corporate claim in a shareholders' derivative suit, there is a right to trial by jury, unless the equitable claims of the shareholders control the entire action, thereby locating jurisdiction in equity and negating the jury right.

Ross answered this question in the negative, holding that, regardless of the source of the shareholder-plaintiff's standing, the right to trial by jury of a basically legal corporate claim cannot be denied.[30] In support of its decision, the Court relied on the post-1938 construction of the right to trial by jury as defined by *Beacon Theatres, Inc. v. Westover*[31] and *Dairy Queen, Inc. v. Wood*.[32]

Examined collectively, *Beacon Theatres* and *Dairy Queen*

[28] Comment, *supra* note 2, at 730. Typical of the state court decisions so holding is Molasky *ex rel.* Clayton Corp. v. Lapin, 396 S.W.2d 761 (Mo. Ct. App. 1965), *cited in*, Comment, *Law or Equity: The Right to Trial by Jury in a Civil Action*, 35 Mo. L. Rev. 43, 48 (1970) ("There is also no right to a jury trial in a stockholders' derivative suit."); *cf.* Godfrey v. McConnell, 151 F. 783 (C.C.D. Mont. 1906)

[29] Ross v. Bernhard, 396 U.S. 531, 534 & n.2 (1970).

[30] *Id.* at 542.

[31] 359 U.S. 500 (1959).

[32] 369 U.S. 469 (1962).

expressly rejected the equitable clean-up doctrine,[33] and *Dairy Queen* held that "the constitutional right to trial by jury cannot be made to depend upon the choice of words used in the pleadings" nor lost because historically legal issues were cast as "incidental" to predominant equitable issues.[34] As to factual issues common to legal and equitable claims simultaneously asserted and as to factual issues embraced solely by the legal claim, the right to trial by jury cannot be destroyed by a prior adjudication of the equitable claim except in the "most imperative circumstances."[35] This was the broad holding of *Beacon Theatres* and *Dairy Queen* from which the *Ross* decision apparently would follow.

However, *Beacon Theatres* and *Dairy Queen* sprung from the Court's termination of what had been a branch of equity's concurrent jurisdiction with law,[36] based on the procedural merger of the Federal Rules of Civil Procedure. As to the shareholders' derivative suit, there had never been any concurrent jurisdiction whatsoever; rather, the suit historically had been recognized only in equity.

Moreover, the factual basis of *Beacon Theatres* and of

[33] The doctrine is explained in 1 J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 71 (5th ed. 1849), *cited in* Comment, *Law or Equity, supra* note 28, at 48 n.65.

> Briefly stated equitable clean-up is the concept that if a ground for equitable relief exists, equity will retain jurisdiction to decide all issues of controversy between the parties to the suit, including the purely legal issues involvd.

Comment, *Law or Equity, supra,* at 48 (footnote omitted.).

[34] 369 U.S. 469, at 477-78, 473.

[35] Beacon Theatres, Inc. v. Westover, 359 U.S. 500, 510-11 (1959); Dairy Queen, Inc. v. Wood, 369 U.S. 469, 472-73 (1962).

[36] Comment, *supra* note 2, at 736.

Dairy Queen differed markedly from that in *Ross*.[87] The former cases involved combinations of historically separable legal and equitable causes of action, while the dual elements of the shareholders' derivative suit were separable for analytical purposes only. Thus, the former cases presented instances of vertical duality in the sense that multiple independent claims were asserted by two parties, each respectively against the other. But the duality of the shareholders' derivative suit is horizontal — shareholders suing the corporation, the corporation suing directors.

Thus, as the Court of Appeals for the Second Circuit displayed,[88] it is clearly possible to distinguish both the facts and the objectives of *Ross* from those of *Beacon Theatres* and *Dairy Queen*. However, the broad language of *Beacon Theatres* and *Dairy Queen* indicates that the Court intentionally was driving its holding beyond the factual issues presented.[89] Therefore, it is not so clear that the holdings in *Beacon Theatres* and *Dairy Queen* can be distinguished from that in *Ross*. Perhaps the underlying significance of *Beacon Theatres* was articulated best by Professor Rothstein when he said that the Supreme Court, in *Beacon Theatres*, was announcing a new approach to the problem of the right to jury trial, but that

[87] In *Beacon Theatres*, plaintiff sought a declaratory judgment and an injunction; defendant counter-claimed alleging violation of antitrust laws and sought treble damages. In *Dairy Queen*, plaintiff alleged breach of contract and trademark infringement and sought temporary and permanent injunctions and an accounting. Defendant answered by denying breach of contract and alleging laches and estoppel and plaintiff's violation of antitrust laws. In each case, it was the defendant who demanded jury trial and the plaintiff who objected.

[88] Ross v. Bernhard, 403 F.2d 909 (2nd Cir. 1968), *rev'd*, 396 U.S. 531 (1970).

[89] Comment, *supra* note 2, at 735-36.

Beacon Theatres was unfortunately a poorly chosen occasion for its enunciation.[40]

Attempts to distinguish *Ross from Beacon Theatres* and *Dairy Queen* based on the practical inseparability of the dual elements of the shareholders' derivative suit result in the drawing of a difference without a distinction.[41] For the *Ross logic* never was intended to rest upon the narrow determinations of the precise legal issues in *Beacon Theatres* and *Dairy Queen,* but upon the broader mandate of the Court's drive toward redefinition of the right to trial by jury in the wake of the Federal Rules of Civil Procedure. Viewed against this background, *Ross* thus properly should be regarded not as an unwarranted extension of the right to trial by jury,[42] but as merely a confirmation of the principles first espoused in *Beacon Theatres* and *Dairy Queen.*

However, even after admitting that there may be a right to trial by jury in the shareholders' derivative suit, a question remains as to the existence of the right in each shareholders' derivative suit. *Beacon Theatres* and *Dairy Queen,* applied to the shareholders' derivative suit, indicate that a right to trial by jury on the corporate claim cannot be lost merely because the source of the shareholders' standing may be equitable. Thus, the sole remaining issue is whether the corporate claim is legal or equitable in nature. The *Ross* Court answered this question by adopting a "basic nature of the issue" test which "is determined by considering, first, the pre-merger custom with reference to such questions; second, the remedy sought; and, third, the practical abilities and limitations of juries."[43] Ths test is applied directly to the corporate claim, rather than to the shareholders' derivative suit as a unitary action.

[40] Rothstein, *Beacon Theatres and the Constitutional Right to Jury Trial,* 51 A.B.A.J. 1145, 1148 (1965).

[41] *Contra,* Comment, *supra* note 2, at 736.

[42] *Contra,* Ross v. Bernhard, 396 U.S. 531, 543-45 (1970) (Stewart, J., dissenting).

[43] 396 U.S. at 538 n.10.

In *Ross*, the defendants were the Lehman Corporation, the plaintiffs-shareholders' closed-end investment company, various individual directors of the corporation and various members of Lehman Brothers, an investment banking firm acting as broker for defendant corporation. It was alleged specifically that more than one half of the board of directors of the Lehman Corporation was affiliated with Lehman Brothers, in violation of the Investment Company Act of 1940,[44] and that this illegal control had been used to extract excessive brokerage fees from the Corporation. Directors of the Corporation were accused of breaches of fiduciary duty, gross abuse of trust, misconduct, willful misfeasance, gross negligence and breach of the brokerage contract between Lehman Brothers and the Corporation. The remedy sought was an accounting for and payment to the Corporation of any profits and gains made by the individual defendants and for any losses sustained by the Corporation. Applying *Dairy Queen*, the Supreme Court held that, although the remedy sought was framed as an equitable remedy, it should be construed as a prayer for money damages.[45] Moreover, although equitable claims likewise were asserted, minimal requirements necessitated a trial by jury on the legal claims—negligence and breach of contract, because the operative facts and allegations did not surpass the practical capabilities of the jury.[46] Therefore, application of the three criteria of the basic nature of the issue test to the corporate claim compels recognition of the right to trial by jury.

Carrying this line of reasoning to its logical conclusion, the Court, through Mr. Justice White, said:

> The historical rule preventing a court of law from entertaining a shareholder's suit . . . is obsolete; it is no longer tenable for a district court, administering both law and equity in the same action, to deny legal remedies to a corporation, merely because the cor-

[44] 15 U.S.C. §§ 80a-1 to-52 (1964).
[45] 396 U.S. at 542.
[46] *Id.* at 539-42.

poration's spokesmen are its shareholders rather than its directors.[47]

The logic behind this reasoning as to remedies also may be applied to the right to jury trial. For if the corporation, on its own initiative, had brought suit against third party wrongdoers, not necessarily its directors, there unquestionably would have been a right to trial by jury as to legal claims asserted. Aside from the obvious opportunities otherwise open to deprive the third party defendant of his jury right,[48] it legitimately may be contended that the right to trial by jury on a corporate claim should not depend upon whether it is the corporation's directors or its shareholders who are ultimately responsible for the assertion of a claim which in fact belongs to the corporation.

The greater significance of *Ross* lies beyond its impact upon derivative suits. Since the adoption of the Equity Rules of 1912, the Supreme Court has moved steadily toward the procedural merger of law and equity,[49] a merger which most nearly reached final culmination in the Federal Rules of Civil Procedure.[50] With this amalgamation has come a federal doctrine which emphasizes substance over procedural form, to which no fact bears greater testament than the one form of action mandate of Rule 2 of the Federal Rules of Civil Procedure.[51] Yet it is clear that, so long as the seventh amendment retains its vitality as a Don Quixote from the past resurrect-

[47] *Id.* at 540.

[48] Both the *Ross* majority and dissent relied on Fleitmann v. Welsbach St. Lighting Co., 240 U.S. 27 (1916), wherein Mr. Justice Holmes recognized the obvious opportunity for fraud. *But see* Glenn, *The Stockholder's Suit—Corporate and Individual Grievances,* 33 YALE L.J. 580, 582 (1924).

[49] MOORE ¶ 38.05.

[50] Address by Professor Sunderland, *The New Federal Rules,* delivered at the fifty-fourth annual meeting of the West Virginia Bar Association, at White Sulphur Springs, West Virginia, Aug. 20, 1938, 45 W. VA. L.Q. 5, 7-8 (1938).

[51] FED. R. CIV. P. 2 states: "There shall be one form of action to be known as 'civil action'."

ing the ghosts of the long buried forms of action to haunt modern federal practice, procedural merger can reach final consummation by moving in but one direction, expansion of the right to trial by jury.[52] Thus, where a choice has lain between expansion or contraction of the jury right, as often it must, if emphasis is placed on substance rather than form, the Supreme Court uniformly has chosen expansion.[53]

The historical test therefore necessarily has become a casualty of the Court's policy of preference for trial by jury. No longer can historical distinctions between law and equity be used as a definitive test of the jury right. The real question has become whether, as to a particular issue, there should or should not be a right to trial by jury,[54] the determinants of which are the criteria of the *Ross* basic nature of the issue test, the first of which incorporates both elements of the historical test. The fact that the Court's new test purports to retain the law-equity distinction as dispositive of the right to trial by jury is a product of the fact that the language of the seventh amendment cannot be totally ignored. However, in *Ross*, the Court affected a redefinition of the terms "legal" and "equitable", such that historical considerations now serve only to set a minimum as to those issues which will be recognized as embraced by the former term. The result is an avoidance of the exclusive effect which the seventh amendment formerly was interpreted as having on the right to trial by jury and a reconciliation of that amendment with the needs of post-merger practice. Moreover, it correctly may be said that the decision in *Ross* moves the Court one step closer to final consummation of the procedural merger toward which the law is tending.

John J. Barnhardt, III

[52] Thirteen states have allowed a trial by jury in "equity" cases. *See* Van Hecke, *Trial by Jury in Equity Cases,* 31 N.C.L. Rev. 157, 158 (1953).

[53] McCoid, *Right to Jury Trial in the Federal Courts,* 45 Iowa L. Rev. 726, 742 (1960).

[54] Address by Professor Sunderland, *supra* note 50, at 7-8; *See also* McCaskill, *Jury Demands in the New Federal Procedure,* 88 U. Pa. L. Rev. 315, 318 (1940).