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FEDERAL PROCEDURE-JURISDICTION-DIVERSITY OF CITIZENSHIP REQUIRED IN STOCKHOLDER'S DERIVATIVE SUIT

Morris G. Shanker
University of Michigan Law School

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FEDERAL PROCEDURE—JURISDICTION—DIVERSITY OF CITIZENSHIP REQUIRED IN STOCKHOLDER'S DERIVATIVE SUIT—Plaintiff, a citizen of New York, instituted a stockholder's suit on behalf of a New York corporation in the United States District Court for the Southern District of New York. Individual officers and directors of the corporation, all citizens of Connecticut, were charged with mismanagement and were joined with it as party defendants. Since plaintiff and defendant corporation were both citizens[1] of New York, requisite diversity did not exist, and the district court dismissed the claim for lack of jurisdiction. Upon appeal, *held,*

[1] A corporation is a "citizen" of the state of its incorporation for the purpose of suing, and being sued, in the federal courts. Barrow Steamship Co. v. Kane, 170 U.S. 100, 18 S.Ct. 526 (1898).

judgment affirmed. The section of the Federal Judicial Code providing that "any civil action by a stockholder on behalf of his corporation may be prosecuted in any judicial district where the corporation might have sued the same defendants"[2] relates solely to venue of such actions. Federal jurisdiction must be determined without regard to this statute. *Lavin v. Lavin,* (2d Cir. 1950) 182 F. (2d) 870.

If federal jurisdiction is to be invoked solely on the basis of diversity of citizenship, it is generally recognized that every necessary party plaintiff must be a citizen of a state different from every necessary party defendant.[3] Since the corporation is considered an indispensable party to a stockholder's suit brought on its behalf,[4] the alignment of the corporation, either as plaintiff or defendant, may become of marked significance in determining whether requisite diversity exists among the parties. As in the principal case, the corporation in a stockholder's derivative suit is traditionally named as a defendant. Logically, it might appear that the alignment of the corporation as a plaintiff is called for, particularly in view of the theories accepted by the federal courts that: (1) the cause of action brought by a stockholder in a derivative suit is that of the corporation, which is the real party in interest, and for whom the stockholder is allowed to act,[5] and (2) the parties to a suit are to be arranged according to their true interests in the controversy.[6] Yet the Supreme Court has shown no disposition to change its rule that a corporation in a derivative suit is to be aligned as a party defendant whenever the corporation is controlled by interests antagonistic to the suing stockholder.[7] An explanation of this seeming inconsistency is usually based on the preliminary steps which the complainant stockholder must take before he gains standing to bring a derivative suit.[8] These steps require that the stockholder first make a demand upon the corporation (through its management) to bring a similar suit on its own behalf.[9] Then, because the corporation rejects this demand and refuses to bring a proper suit on its own behalf, its alignment as a party opposed to the suing stockholder is required. The words of the Judicial Code, supra, suggest the possibility that a deviation from the general rule of diversity jurisdiction is to be allowed in a derivative suit whenever the corporation could have hypothetically maintained the same action against the same defendants in the federal courts. Thus, it is suggested that federal jurisdiction is to be invoked whenever requisite diversity exists between the corporation and the remaining defendants notwithstanding the fact that such diversity does not exist between

[2] 28 U.S.C. (Supp. II, 1949) §1401.

[3] BREWSTER, FEDERAL PROCEDURE 44 (1940).

[4] Davenport v. Dows, 18 Wall. (85 U.S.) 626 (1873).

[5] Koster v. Lumbermen's Mutual Casualty Co., 330 U.S. 518 at 522, 67 S. Ct. 828 (1947). See 132 A.L.R. 193 (1941).

[6] Pacific R.R. v. Ketchum, 101 U.S. 289 (1879). See 132 A.L.R. 193 (1941).

[7] Doctor v. Harrington, 196 U.S. 579, 25 S.Ct. 355 (1905); Koster v. Lumbermen's Mutual Gas Co., supra note 5.

[8] 27 N.C. L. REV. 558 (1949).

[9] That the stockholder has made an attempt to secure from the corporation management proper relief is required in the allegations. Rule 23(b), Fed. R. Civ. P. (1948).

the suing stockholder and the defendant corporation. However, the courts have consistently rejected this possibility. Rather, the interpretation invariably given to this section of the code is that it relates solely to the venue in which a derivative action may be brought;[10] and that requisite diversity among all necessary parties, as determined by the general rule, must first be established before the section has any application.[11] The decision in the principal case follows this view. Yet the consequences of the decision may be to deny to the plaintiff any possible court remedy, for the federal courts cannot take jurisdiction over the cause, while the state courts may be helpless to gain jurisdiction over all the necessary parties without their consent. A possible solution might be to permit realignment of the corporation as a party plaintiff if necessary to sustain federal jurisdiction. However, the judicial penchant to narrow federal jurisdiction when based solely on diversity of citizenship[12] makes this appear unlikely. Rather, it appears that relief from this dilemma must come from congressional legislation specifically enlarging federal jurisdiction of a stockholder's derivative suit.

Morris G. Shanker

[10] Schoen v. Mountain Producers Corp., (3d Cir. 1948) 170 F. (2d) 707 at 711, note 4; Saltzman v. Birrell, (D.C. N.Y. 1948) 78 F. Supp. 778.

[11] Saltzman v. Birrell, supra note 10.

[12] Healy v. Ratta, 292 U.S. 263, 54 S.Ct. 700 (1934); Shamrock Oil & Gas Corp. v. Sheets, 313 U.S. 100, 61 S.Ct. 868 (1941).